ODERN BUSINESS

Its Organization and Management

Ninth Revised Edition

SATYA SARAN CHATTERJEE

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PREFACE TO THE NINTH EDITION

In this ninth edition, the book has been thoroughly revised and extensively changed in the light of all recent developments. Topics have been recast and additional matters have been introduced throughout the book for presenting the subjects anew. All pertinent information and latest data relating to management, financing, marketing, labour, transport and industrial development have been incorporated with proper analysis and synthesis. A sincere attempt has been made in this new edition to present the material with as much lucidity and brevity as possible.

The Department of Commerce
The University of Burdwan
March 1975

S. S. Chatterjee

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PART ONE—INTRODUCTION

CHAPTER 1

THE NATURE AND PURPOSE OF BUSINESS

MEANING OF BUSINESS

Business may be defined as recurring sales of those goods and services which are either produced by the seller or purchased from other producers in the given form. No matter whether the goods and services are produced or purchased, the recurring sales provide the identifying mark of business and constitute the essence of it. Since sales imply an exchange of values between the buyer and the seller to their mutual advantage, business may be said to be consisting of two primary elements—exchange and mutual advantage.

That *exchange or transfer of goods and services* provides the vital test of business can be shown by separating business activities from other allied activities. Production or purchasing of goods and services for personal consumption does not constitute business, but such purchasing or production becomes business when goods and services are meant for sale. For example, production of wearing apparels at home through the use of sewing machines does not amount to business activities, while production of the same wearing apparels by a cloth mill or a tailoring shop is no doubt business. Again, purchasing of goods and services is done by both shopkeepers and ultimate consumers. Purchasing by shopkeepers falls under business activities, but it is not so in the case of purchasing by consumers. Put in brief, it is the element of exchange that singles out business activities from all those countless human activities which are directed towards producing or acquiring wealth in our society.

The second element of business lies in *the realization of certain benefits by both the buyers and sellers.* Businessmen, as the seller of goods and services, supply satisfaction benefits to buyers through the provision of form utility, place utility, time utility and possession or ownership utility. In return for the supply of utilities, businessmen receive money or profit benefits from the buyers. That is to say, wherever buying and selling transactions are not mutually beneficial to both the parties, mere exchange of goods and services does not result in business.

Recurring sales rather than one or two isolated deals are the hall-mark of business. To illustrate, the construction or purchase of a building for residential purpose and the subsequent sale of the building by the owner do not make for business activities. But recurring sales of different buildings on the part of building societies and construction companies are activities that come within the category of business. To be recognized as business activities, production or buying on the one hand and selling on the other must be repeated operations. A business concern does not spurt in an isolated deal for liquidating itself at the next deal.

Selling results in the transference of goods and services from the seller to the buyer. To make this transference possible, *the seller must possess the required goods and services.* As there are two ways of possessing goods and services, namely, production by the seller him-self and purchasing from other producers by the seller, business activities can be sharply divided into two classes—Industry and Com-merce. When goods and services are produced from the purchased materials by the seller himself, business goes by the name of industry. Business takes the name of commerce where the seller purchases goods and services from others for making them available to consumers through the assistance of numerous marketing agencies and service concerns. To summarise the nature of business in the words of Haney, "On the one hand, business rests on the technical processes of trade and manufacture ; on the other hand, it looks to the market. At the junction stands the business man, either directing the technical process of production or gauging the market, or doing both ; but always engaged in buying and selling for the purpose of gain."[1]

Goods and services are *the wares of dealing in business.* In addition to countless movable goods starting from a tiny pin to the giant machine, some immovable property like buildings and bridges are covered by the term "goods" in business. Furthermore, goods include both domestic consumption goods and industrial consumption goods, *i.e.*, finished goods and raw materials. Also, business deals in services which are intangible or invisible in nature and which cannot be stored for future consumption. For rendering services of diverse types, many business concerns come into existence and cater to the needs of industry and commerce as well as to the direct wants of consumers. Examples of business concerns that sell services include companies for transportation, communication, electric power, insurance, lodging, amusement and many other household and personal services. To take the case of transporta-tion, there are several transport agencies or media which carry raw materials for production purposes, move finished goods for distribution

[1] Haney, L. H., *Business Organization and Combination*, p. 3.

or marketing purposes, and provide direct service to passengers in carrying them from one place to another.

CLASSIFICATION OF BUSINESS ACTIVITIES

Business activities can be placed under two main divisions—Industry and Commerce.

Industry. It is concerned with the production of those goods which are used either as raw materials by other enterprises in further production or as finished products by final consumers. That is to say, industry processes or fabricates goods for using them either as producers' goods or as consumers' goods. Industry may be of four different types, *viz.*, genetic, extractive, manufacturing and construction.

Genetic industries—True to their name "genetic" which means parentage or heredity, these industries remain engaged in breeding plants and animals for their use in further reproduction. For breeding plants, the seeds and nursery companies are typical examples of genetic industries. In addition, the activities of cattle-breeding farms, poultry farms and fish hatchery come under the class of genetic industries.

Extractive industries—They extract or draw out their products from natural sources. Extractive industries supply some basic raw materials that are mostly the products of the soil. Products of these industries are usually transformed into many other useful goods by manufacturing industries. Important extractive industries are related to farming, mining, lumbering, hunting and fishing operations.

Manufacturing industries—Industries engaged in producing goods through the creation of form utilities are known as manufacturing industries. They turn out diverse finished goods through the treatment of raw materials or partly finished materials in their manufacturing operations. What is known as 'factory' production is the outcome of manufacturing industries. Most of the goods for our everyday use are supplied by manufacturing industries, and the greater part of commercial activities revolves round the products of manufacturing industries.

Construction industries—They are concerned with construction, erection or fabrication of products on a large scale. Products of construction industries can be sharply distinguished from the output of other industries and such products are to be built on sites where construction takes place. Construction industries embrace the erection of buildings and stadiums, the making of docks, dams, bridges and roads, as well as the cutting of tunnels and canals. Engineering and architectural skills play an important part in construction industries. Accordingly, engineering and contracting firms are organized for undertaking the operation of construction industries.

Commerce. Commerce is the business of buying finished goods and materials from producers with the object of selling them to consumers. Between buying from producers and selling to consumers, there arises the necessity of assuming a chain of activities and of providing a number of services in commerce. Commerce embraces all such activities and services that are required for bringing the goods to the hands of ultimate consumers. Direct selling to final consumers is rather an exception nowadays on the part of producers. Places of production and consumption are widely separated and lie scattered throughout the globe. It is the task of commerce to collect or assemble the goods from various centres of production, on the one hand, and to disperse or distribute the goods over numerous points of consumption, on the other. For collecting and distributing goods, the activities like transporting, packing (for transport purposes), warehousing, insuring and financing become necessary for maintaining the steady flow of goods to the market. Furthermore, for aiding actual sale to final consumers, the advertising, packaging, grading, dividing or other related activities have to be gone through in commerce in many cases. Briefly, commerce increases the usefulness of goods and meets consumers' satisfaction through the addition of time utilities, place utilities and ownership utilities to goods.

Commerce has been defined by one writer as "the sum total of those processes which are engaged in the removal of the hindrances of persons (trade), place (transport and insurance), and time (warehousing) in the exchange (banking) of commodities."[2] To condense this definition, commerce denotes trading, transporting, insuring, warehousing and banking activities. But this oft-quoted definition of commerce has three shortcomings. *First,* the comparative importance of different activities has not been indicated in the definition, and it is not clear whether trading stems from other activities or other activities stem from trading. *Secondly,* activities like advertising, packaging, etc., have been left out. But today they have become vital for the very existence of a business concern, irrespective of its engagement in industry or commerce. Operation of so many advertising agencies and packaging companies bears testimony to the importance of these activities. *Thirdly,* exchange of commodities is not fully covered by banking activities.

Trade. Commerce is primarily concerned with the sale, exchange or transfer of goods to the buyer, and as ancillary activities to this sale, it is also concerned with other related activities including the purchase of goods from producers. Selling is of paramount importance in commerce and involves that branch of commerce which is known as trade.

[2] Stephenson, J., *Principles and Practice of Commerce*, p. 95.

Trade of different categories, retail and wholesale, local and regional, domestic and foreign, provides the solid foundation upon which the superstructure of commerce has been raised. It is trade around which all other activities of commerce rotate and get nourishment.

Interrelationship of Business Activities. Industry, trade and commerce are closely interrelated with one another. One cannot achieve its purpose without the aid of others. Industry cannot carry its production without the help of commerce. Commerce comes to the rescue of industry before and after production through buying raw materials, selling finished goods and doing many other operations. Commerce supports and is supported in turn by industry, because the greater part of commercial activities revolves around industrial operations. Trade being concerned with buying and selling goods provides the life-blood to industry and maintains the even flow of commerce. Thus, industry, commerce and trade are interlocked with one another.

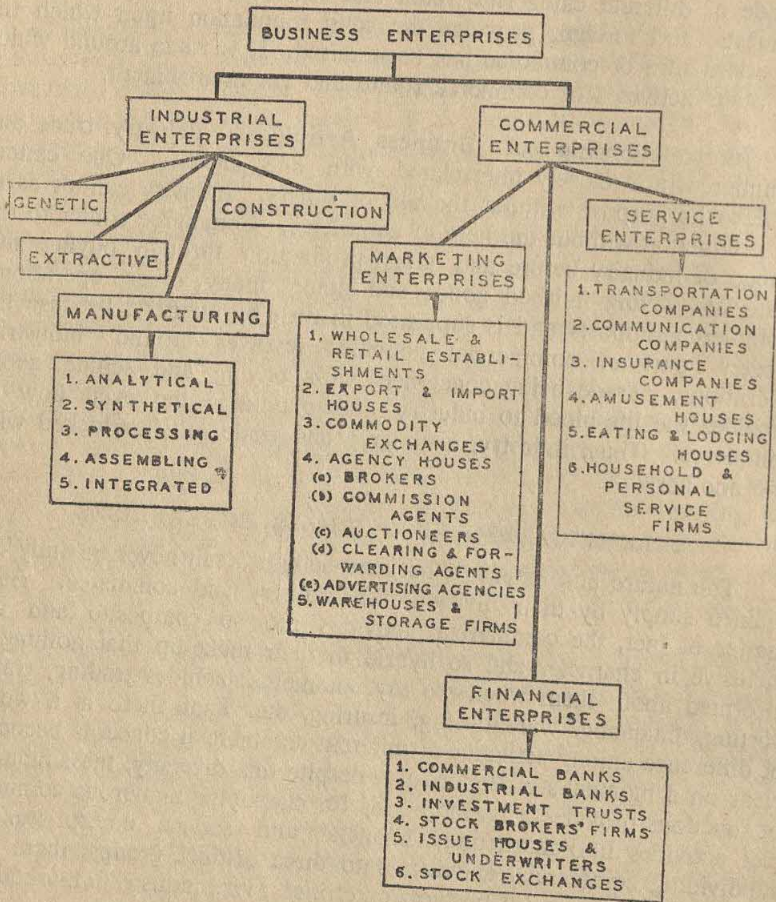
CLASSIFICATION OF BUSINESS ENTERPRISES

The nature and extent of business activities can never be fully explained simply by their division into industry and commerce. As a matter of fact, the commercial activities are so composite and all-inclusive in character and so hybrid in their make-up that nothing is informed about them when we say commerce includes trading, transporting, financing, warehousing, insuring, etc. That there is a world of difference among activities of different commercial concerns becomes clear on a moment's reflection. But despite this diversity, the similarity of functions provides a realistic basis for classifying numerous commercial activities into marketing, financial and service enterprises. By subdividing commercial activities into three distinct groups, there are thus four broad types of business enterprises, *viz.*, industrial, marketing, financial and service enterprises.

Before poing into the details of these enterprises, constituent parts of different enterprises along with their interrelations may be explained by the diagram given on page six.

Industrial Enterprises. As pointed out earlier, industries are of four different types, *viz.*, genetic, extractive, manufacturing and construction. Of these, manufacturing industries vary widely among themselves according to the nature of their productive operations. From their differing nature of operations, the manufacturing industries fall into the following five categories :

Analytical industries—Some basic raw materials are broken down into several parts or products that are made available for consumption



by analytical manufacturing industries. They make apart many products from materials in different stages of their production. Petroleum refining is a classic example of analytical industries. The raw oil that is extracted from the earth is worked out into gasoline, kerosene, diesel oil, lubricating oil, tar, insecticides and many other useful products. Majority of chemical industries belong to the category of analytical manufacturing type. As the main branches of a tree stem from its trunk and then spread out into numerous small branches and leaves, so the analytical industry yields diverse products from one principal raw material.

Synthetical industries—In contrast to analytical industries, synthe-

tical (or synthetic) industries mix two or more materials together in their manufacturing operations to obtain some new products. The plastic industry is a typical example of this type of manufacturing. Many products like soap, fertilizer, cement, paints and cosmetics are derived from this industry. Like the main stream of a river that is fed by its tributaries, the final products of synthetical industries come out from the addition of several materials in different stages of production.

Processing industries—They process or work out raw materials into finished products through a series of manufacturing operations. For processing materials, the analytical, synthetical or conditioning methods are usually adopted in this type of manufacturing. Under conditioning method, no addition of materials or seoaration of by-products is made in the manufacturing stage as in the case of jute and cotton mill industries. Milk processing and flour-milling are the relevant operations of analytical processing industries. Steel making and plate-glass manufacturing involve operations of synthetical processing industries.

Assembling industries—These industries combine many manufactured parts to obtain some finished products of a complicated nature. Automobiles, typewriters and bicycles are the common products of assembling industries. Assembling industries must, however, be supported by other types of manufacturing for providing them with requisite parts in their assembly lines.

Integrated industries—Many manufacturing enterprises are of the integrated type wherein processing and assembling are combined under one concern. Manufacturing of rubber tyres consists of both processing and assembling operations. The iron and steel industry combines processing and assembling in addition to the extraction of materials from the ground.

Marketing Enterprises. Marketing enterprises comprise those concerns which have to do something with the sale of goods in the market. Many agencies and firms come under these marketing enterprises and confine their activities to the mere selling of goods. One peculiar characteristic of these marketing enterprises is that they have no other dealings with ultimate consumers except the sale of goods, but they have to make frequent dealings with other business concerns. Marketing enterprises can be subdivided into three groups.

In the first place, trading firms include wholesale and retail establishments as well as import and export houses. Commodity exchanges too are essentially trading organizations. To aid the actual sale of goods and to reduce the burden of customs duty, many imported goods are packaged nowadays by trading firms, particularly in the case of drugs.

Secondly, marketing enterprises embrace many agency firms which

facilitate the sale of goods by trading organizations. In addition to brokers, commission agents and auctioneers, the advertising agencies as well as the clearing and forwarding agents have steadily grown in importance. Advertising agencies have no direct connection with final consumers, and they confine their dealings with other business concerns. Clearing and forwarding agents make arrangements for the physical transfer of goods after their sale by trading firms ; packing and dividing are effected by them in many cases in addition to the provision of clearing and forwarding facilities.

Finally, warehouses and storage firms are marketing enterprises, and they are not service enterprises as erroneously believed by some. Goods of other business enterprises are stored therein for balancing the time-lag between production and consumption.

Financial Enterprises. As distinguished from both marketing and service enterprises, the financial enterprises deal in funds for meeting the needs of businessmen as well as of other persons. They mobilize savings of the community for their investments in other business establishments and in giving loans to individual parties. One group of financial enterprises is formed by banks of several kinds, investment trusts and the like institutions. Another group is composed of stock exchanges, issue houses, and firms of stock brokers and underwriters. They do not lend funds of their own, but they encourage direct investment in business on the part of individual and institutional savers.

Service Enterprises. A great many and varied concerns come under the class of service enterprises. The distinguishing nature of a service enterprise is its direct dealing with final consumers. Service enterprises sell services that are intangible in character and that cannot be stored for future consumption. Some service enterprises sell their services to both the consumers and other business enterprises, but there are some that cater to the needs of final consumers alone, *e.g.,* services of eating and lodging houses, amusement houses, and the household and personal service concerns. What are known as public utilities come also under the class of service enterprises, and they include important means of transportation and communication in addition to coal-gas and electric-power companies. As a rule, public utilities are mostly State-owned enterprises, and where they are not owned as such, severe State regulations are exercised over the working of public utilities.

For clarity of understanding, the following kinds of service enterprises may be discussed in brief :

1. *Transportation companies*—The saleable product of transportation concerns is movement. This service of movement is provided for

carrying both the goods and passengers by railways, airlines, shipping lines, motor vehicles and many others.

2. *Communication companies*—Communication means conveyance of ideas and information between individuals or institutions. Communication services are provided by telephone, telegraph and radio through the use of electrical impulse. Postal mail is another means of communication. Publishing concerns provide communication services by way of distributing newspapers, journals, books and other printed matters. The value of a publication lies in its information and ideas, not in the quantity of paper it contains ; hence publications should not be confused with other tangible products.

3. *Insurance companies*—They are service enterprises engaged in selling the service of protection against many hazards in our society. Both individuals and business institutions utilize these services for securing protection against material loss, damage or liability.

4. *Amusement houses*—Cinema and opera houses and many other entertainment concerns are service enterprises that provide recreation services for mass enjoyment.

5. *Eating and lodging houses*—Hotels, motels, restaurants, cafetarias and other like concerns provide direct services to consumers alone, and they do not cater to the needs of other business enterprises. Lodging houses provide the services of shelter to their guests ; eating houses supply food as well as the facility of eating. For this differing facility of eating, one cup of tea with no quality difference may cost 20 paise in one establishment and rupees two in a different eating establishment.

6. *Firms of household and personal services*—Household services are rendered by dyers and cleaners, laundries, decorators and the like of them. Personal services are rendered by hair-cutting saloons, beauty parlours and others.

Professional Services. Personal services are also rendered by a large body of professional firms and individuals like management consultants, tax consultants, medical clinics, nursing homes, legal advisers, audit firms, etc. Professional services, however, do not fall within the ambit of business, and such firms are not regarded as service enterprises because of their several distinguishing marks. *First,* a high degree of formal education is necessary for acquiring the special knowledge, experience and skill by professional men. Moreover, membership enrolment in their respective professional associations is compulsory on the part of professional men in many cases. *Secondly,* services are rendered confidentially to the clients who must accept such services with absolute faith and reliance. *Thirdly,* services are rendered for a remuneration that is called "fee", the amount of which may vary

from one client to another according to the discretion of professional men. *Finally*, many professional callings prohibit their members from making any public advertisement.

MOTIVES AND OBJECTIVES OF BUSINESS

Motives differ from objectives both in their meanings as well as in significance. Motives represent the desire which causes a man to act, while objectives imply the goal of human activities. Motives remain confined in the mental realm of human beings as thoughts and desires. In contrast, objectives are concerned with the purpose of outward activities that human beings undertake for the fulfilment of their motives. Hence, motives and objectives of business do not necessarily mean the same thing. Motives explain why men enter into business and stay in business. The obvious motive for business activities is profit making. It is needless to add that individuals do not choose business careers for improving their health or for finding salvation of their soul. Profit provides the basic incentive or stimulus to human efforts in business activities, and this motive to earn profit remains uppermost in the minds of businessmen.

And yet, profit making is not the sole or self-exclusive motive of human beings for business activities. There are other motives at play which may induce persons to enter into a new business, or to continue an old business. Social power and prestige and the joy of achievement that business activities bestow upon human beings are no less significant. Business is no longer an inglorious career meant for the illiterates and outcastes. Through business leadership comes social leadership which in turn earns power, prestige and recognition for the businessman. That social leadership is an important incentive to human efforts can be verified from the lifelong activities of many political workers. That is to say, profit does not provide the full answer to the question, "why do men enter into business".

Despite other motives, the profit motive cannot be supplanted in the private sector of economy, and it will continue for ever to be the primary motive for business activities. But this should not lead us to think that profit is the primary objective of business. Objectives provide goals or aims towards which all efforts in business are to be directed. If profit is erroneously regarded as the primary objective of business, profit maximization becomes the only goal of all operations of a business enterprise. We know that profit can be maximized by many nefarious practices like exploiting workers, deceiving suppliers, evading taxes, adulterating goods, or passing products of inferior quality to customers. These sharp practices would evidently swell up profit, but at the same time, the character of activities in such a situa-

tion would change from business to swindle. If business is not taken to be what swindle means, profit cannot appear as the real objective of business.

What, then, is the real or primary objective of business ? The primary objective of business is to supply useful and quality goods and services to consumers through the creation of several utilities. As a reward for the creation of utilities, businessmen are entitled to make reasonable profits as their remuneration. As pointed out by Urwick, an international authority on business management, "profit can be no more the objective of a business than . . . . eating is the objective of living".[3] Just as human beings do not live for the sole objective of eating, likewise there can exist no business for the only purpose of making profit. But although too much eating is bad for health and efficiency, a certain minimum is essential for living and working. Similarly, a certain minimum profit is as much necessary for the survival of a business as eating is for living.

The primary objective of supplying desirable goods and services cannot be fulfilled unless it is supported by some other secondary objectives of business. Goods and services are produced and distributed with the help of several factors of business operation, *viz.*, materials (land), men (labour), money and machines (capital), and management and methods (organization). Profit can be inflated in the short period by reducing expenditures for maintenance, upkeep or development of the factors of operation. But such reduction in developmental expenditures amounts to self-destruction and may lead to the elimination of business itself. To maintain the steady supply of quality goods and services at reasonable prices, there must be a number of secondary objectives relating to each of these factors of operation. Labour objectives call for the provision of fair wages, satisfactory working conditions and steady employment. Capital or ownership objectives demand the conservation of assets and the payment of some minimum return on investment. If this minimum return is not guaranteed, additional capital would not be forthcoming in the business and the life of the business may be terminated. Likewise, there should be objectives in regard to materials procurement, management development, and methods improvement.

SOCIAL RESPONSIBILITIES OF BUSINESS

Business is said to have two aspects—*individual and social*. The profit motive represents the individual aspect, while social obligations

[3] Urwick, L., *The Elements of Administration*, p. 27.

constitute the social aspect of business. The primary objective of supplying desirable goods and services at the acceptable price makes it crystal clear that business has an inescapable responsibility to the community as a whole. And to discharge this responsibility, profit motive must always be tempered with social obligations of business. A business unit comes into existence through the combination of some material and human resources for producing and exchanging values in the form of goods and services. As a result, the fulfilment of the primary objective depends upon the wise and efficient use of resources. For supplying quality goods and services at acceptable prices, business creates obligations to those who provide the resources—owners, employees and the community. Business operates through the mutual support and co-operation of all these interested groups. Accordingly, for obtaining that support and co-operation, the demands and wishes of these groups must be met by all business enterprises. Without the support of owners, capital investments would be dried up. In the absence of employee co-operation, business would become lifeless. It is the employees who supply the breath of life, the brain and brawn, to any business. The community, through the Government of the nation, provides the necessary economic and political environment for the operation of business and expects in turn the satisfaction of public interests by way of creating jobs, supplying improved goods and services, and utilizing scarce resources in the best possible manner.

Social responsibilities are common to all business enterprises in the public, private or co-operative sector of economy. Still there is a basic difference between private enterprises, on the one hand, and State (or public) and co-operative enterprises, on the other. Absence of profit motive in the latter case makes all the difference between them. But profit is the measuring rod of business performance, the test of efficient business operation. Furthermore, a certain minimum profit is regarded as one of the secondary objectives of business for its survival. Despite the absence of profit motive, the public and co-operative enterprises are not immune from this secondary objective of profitability. True, public enterprises can produce and distribute their goods and services at the cost price without making any profit at all for the furtherance of public welfare. But activities of such a nature amount to relief work, not business in the real sense of the term. Relief work is practicable on the part of public enterprises, because they receive their revenues from the Government through public taxation. If public enterprises are wanted to be self-supporting in their business operations, profitability objective is as much necessary in their case as in private enterprises for safeguarding against inefficient operation and uneconomical manufacture.

BASIC COMMON FEATURES OF BUSINESS

Despite their varying nature and activities, all business enterprises have some common features which may be listed under the following seven heads :

1. *Entrepreneur*—It is needless to say that no business can come into existence without the pioneering efforts and promoting activities of some individuals. It is the entrepreneur who visualizes a business, sets it as an organized enterprise and puts it as a going concern. Although individuals are found to promote small business, institutions are engaged for floating big business.

2. *Organization*—As organization is prerequisite for successful operation, every enterprise has to be organized in some way or other. Organization calls for dividing activities into departments, sections and jobs as well as for combining all such activities into an integrated whole. Organization creates the framework for managerial performance and holds the key to co-ordination of efforts and activities.

3. *Finance*—Business enterprises are deeply embedded in finance and cannot move a step without it. Apart from the supply of fixed and working capital, the availability of other factors of production and resources is dependent upon it. Finance permeates through all business activities and calls for tendering care.

4. *Forecasting*—Peering into the future is effected through forecasting which reveals the prospects and problems of future. Forecasting is the precursor of business planning for indicating the future course of action. With the enlargement in the size of business, the need for and importance of forecasting gradually increase.

5. *Risk and uncertainty*—Business is beset with risks and uncertainties which cannot be covered by insurance. These risks include strikes, floods, earthquakes, changing demand, falling prices and other like events. Although forcasting and insurance can reduce the degree of risks, there are many other risks which are borne by business enterprises.

6. *Surplus creation*—Surplus is created when the income of a business exceeds its expenditure. As the growth of business is always financed from the surplus, it is rather indispensable for every business to arrange for it. Steady and continuous existence of the business is also dependent upon surplus for a number of reasons.

7. *Public purpose*—As business is a social institution, it must look to the public good. To put emphasis on this public purpose, a great stress is laid nowadays on the social aspect of business and social obligations of business. Bereft of any public purpose, the business enterprises are looked upon as swindling dens. As no business can

operate without public support and co-operation, it is obvious that the business enterprise must serve some public purpose.

THE FORMAL STUDY OF BUSINESS

Business, as a subject of formal study, merits attention and acquires importance in our society, because the largest number of people remain engaged in this branch of human activity. Business affects almost all of us by the nexus of consumers, employees, or of owners thereof. Despite this pervading influence of business activities, adequate attention was not given for studying Business as a subject of formal education before the beginning of the present century. This negligence towards such a vital branch of human activity can be explained by two contributing factors. First, up to the greater part of the nineteenth century, the business career was not socially approved to be honourable ones, and such activities were practised by uneducated persons and backward sections of the community. Secondly, business activities were of simple types because of their commercial character before the advent of large-scale industrialization. Consequently, such activities did not deserve the attention of educated persons, social thinkers and research scholars.

The complexities of modern business have compelled us to change our notion about business activities in the present era. The rapid growth of industries, the giant strides in technological (inventions) and technical (innovations) advances, and the rise of formidable barriers like Governmental regulations, labour unionism, etc., have made the business careers as one of the best choices in modern life. To mention this change in our concept of business activities, it can be pointed out that a few decades back the dullest boy of the family was put into a business for making his career ; but today the most bright boy of the family is tipped for having a business career. To prepare for careers in business activities, the system of practical experience through apprentice training is no substitute for formal education. Training through experience alone is insufficient for meeting the needs of present-day business activities. It takes too long a period to prepare for business careers ; it fails to provide a broad understanding of back-ground situations in business careers ; and it may result in imparting wrong experience, because under the system of practical training, hidden tricks, inner clues or mysterious practices are taught to the candidates rather than the knowledge of principles. Evidently, knowledge of Business through formal education is not enough by itself for business careers. Such formal education is required to be supple-mented by practical training for preparing the candidates for successful and effective business careers.

Business and Economics. Business and Economics are allied social sciences which study the material aspects of human life in our society. Economics studies human activities that are directed towards production or acquisition of wealth in the form of goods and services. No matter whether the goods and services are exchanged or not, Economics encompasses all human activities centring round wealth making and wealth spending. In contrast, Business confines its study to those human activities which arise from the exchange of goods and services, whether produced or purchased. From the coverage of human activities, Economics is larger in scope than Business. But from the depth of study, Business analyses human activities more thoroughly than Economics does. Economics is concerned with studying certain causal relationships between human activities along with the formulation of some broad objectives and policies for the economic betterment of our society. On the contrary, Business deals with concrete realities of human life for the actual supply of goods and services to meet such human wants. In this "practical" aspect of human life rather than its "theoretical" aspect, Business is a much deeper, useful and exacting social science.

Because of the wider coverage of human activities, Business is erroneously taken by some to be a part of the study of Economics. We know that Sociology is wider in scope than Economics ; accordingly, it can never be said that Economics is a part of Sociology with no separate existence. Furthermore, it is pointed out by others that Business is merely an outgrowth of Economics, and it has no independent sphere of study. True, Business has appeared on the stage at a much later period and has borrowed some knowledge of Economics in codifying its body of principles. It is well known to all that Philosophy is the progenitor of all social sciences. For this early evolution of Philosophy, nobody can claim that other social sciences like Sociology and Economics are branches of Philosophy. Similarly, it is ridiculous to suggest that Business is a branch of Economics.

The operation of a business concern is guided and directed by its management. To study Business calls for a study of its management, the most active element of any business concern. Economics has been in existence for centuries together in our society, but it has failed to keep pace with physical and biological sciences in making material contributions. Much of our miseries and vices can be ascribed to the uneven progress between physical and social sciences. To bridge the gap of uneven progress, a greater reliance has been placed upon the management science which is expected to make the hoped-for future accomplishments in our society. As a matter of fact, the second half of the present century has already been recognized as "management era" in the industrially advanced countries of the world.

Business and Ethics. Ethics deals with moral duties and personal conducts of human beings in their everyday activities. Ethics screens out right actions from the wrongful ones for providing a guide to human conduct. By applying the principles of Ethics in the sphere of business, we find the development of Business Ethics for the guidance of businessmen. Business Ethics calls for the importance of playing fair with consumers, employees, suppliers, competitors and other related parties. History and experience show that a country cannot make sufficient progress in business activities without the establishment of a sound standard of business ethics. Civil law cannot fully regulate the conduct of business operations unless it is supported by the moral law of Ethics. Observance of civil law does not result in compliance with moral law in all cases. On the contrary, where violation of civil law is rampant, the tendency towards violation of moral law is accelerated. As moral law is based upon the individual virtues of human beings, Business Ethics prescribes certain virtues like turth, justice, persistence, courage, thrift, philanthropy and so forth, on the part of businessmen.

Business and Other Sciences. Business has borrowed the available knowledge from other behavioural sciences like Sociology, Psychology, Political Science and Cultural Anthropology in building its own philosophy. Business utilizes the knowledge of Sociology relating to "group behaviour" so far as its dealings with consumers' groups and workers' groups are concerned. Psychology assists Business in measuring workers' reactions or consumers' reactions that may develop in response to different situations. For this purpose, psychology of advertising and industrial psychology are the two practical contributions of this science to Business. Knowledge of Political Science provides the understanding of economic and political environment in which all business enterprises are to operate. Without being acquainted with the system of Government and its nature and extent of control, operation of any business becomes an impossibility. A background knowledge of Political Science is conducive to the future success of a business enterprise, since socio-economic trends can be studied in years ahead of their actual coming. Cultural Anthropology assists Business in understanding human problems and taking remedial action. In the sphere of human relations, many insights into human character and behaviour are furnished by the knowledge of Cultural Anthropology. Besides behavioural sciences, Business is greatly dependent upon quantitative sciences like Accountancy and Statistics. Although general accounting and cost accounting have been of great use to Business for a long time, Statistics is nowadays making large inroads into the area of planning and controlling activities of Business.

CHAPTER 2

SIGNIFICANCE OF ORGANIZATION, MANAGEMENT AND CONTROL

MEANING OF ORGANIZATION

Organization means the way in which the parts of an enterprise are put into working order. To put the parts of a business into working order calls for the determination of parts, on the one hand, and the integration of parts as one complete whole on the other. This is precisely what the act of organizing entails. In other words, organization is a process of dividing and combining activities of an enterprise. Activities of an enterprise are required to be distributed between departments, units or sections as well as between persons for a number of reasons. *First,* organization is necessary only in those cases where the total activities cannot be performed by one person. Evidently, when two or more human beings are engaged in an institution, the task of each member is to be fixed through the division of total activities among them. *Secondly,* benefits of division of labour and specialization can be secured only when the total activities are divided on the basis of knowledge, experience and capacity of different persons. *Thirdly,* all the activities are not of equal importance in any concern ; some are more important than others. Division and subdivision of activities permit to place the requisite importance on all activities.

Activities are required to be integrated or combined for giving them a commonness of purpose. Activities relate to one concern and are necessary for the fulfilment of certain common aims. Consequently, all activities are pulled together or co-ordinated in one direction for getting the maximum results of human efforts. Organization is necessary for business enterprises as well as for all those social institutions which are composed of a group of human beings, whether in the capacity of employees or others. It follows, therefore, that there can be diverse types of organization like educational organization, governmental organization, religious organization, or cultural organization in addition to business organization. Again, organization for the business may be split into industrial organization, trading organization, financial organization, and the like of them.

Organization is the logical arrangement of work and of work facilities. "To organize a business", says Fayol, "is to provide it with everything useful to its functioning : raw materials, tools, capital, per-

sonnel"[1]. Leaving aside material resources like capital, tools and materials, the provision of human resources and the fixation of their duties and mutual relationships are now regarded as the core of the organizing function. The establishment of a business under one form or another like proprietorship, partnership, company, etc., is not what is meant by organization. Irrespective of their forms, all business enterprises require organization for their economical operation and smooth running of business. The larger the size of a business, the more complicated and formal becomes the task of organizing. In contrast, the organizing work is of simple and informal nature in small-sized enterprises.

Process of Organization. The form of the business is nothing but an organ of action. The organ in itself, whether good or bad, is useless unless arrangements are made for the playing of organ. Organization is the means of putting the organ in action. Like an orchestra, organization makes the enterprise ready to pulsate with life and action. The following are the important steps in organizing any business :

1. *Determination of activities*—From the nature of business and the purpose of the enterprise, the total volume of work is ascertained through its breakdown into component activities. For example, the major activities of an industrial enterprise include production, sales, financing, purchasing, personnel, etc. Besides these activities, many other activities become necessary for carrying out the major activities of a business. To take some examples, engineering, advertising, accounting, store-keeping, and recruiting activities are to be found in all industrial concerns.

2. *Grouping of activities*—Correlated and similar activities are grouped into units and subunits. Departments or units are first created on the basis of major activities, and departments are then split into subunits or sections for grouping other supporting activities. Primary grouping of activities is effected by various means, *viz.*, enterprise functions (like production, sales, personnel etc.), products manufactured by the concern, and geographical areas of business operation. Secondary grouping of activities into sections is made on a number of bases like types of customers, productive processes, equipments used, geographical areas and others. Grouping of activities results in creating departments and levels of the organization structure and the process is referred to as departmentation.

3. *Allocation of fixed duty to individuals*—Each individual is made responsible for the completion of a specific job in the enterprise. Jobs are allocated to persons on the basis of their skill, experience and ability. Assignment of fixed jobs to definite persons ensures certainty in work performance. Moreover, fixed duty aids in speeding up the

[1] Fayol, Henri, *General and Industrial Management*, p. 53.

work and assists in the maintenance of discipline in the enterprise. Briefly, the shirking of work is made difficult by the allocation of fixed duty to different persons.

4. *Delegation of authority*—Delegation of authority calls for the grant of requisite authority or power by the chief executive to his subordinates. Authority and duty are correlated terms. Authority without duty creates despots, while duty without authority makes a man impotent. For enabling the subordinates to discharge their duties, necessary authority is required to be vested in them. Delegation is the means of extending the limited personal capacity of an executive. With the vesting of duty and authority, the delegatee is held accountable to the delegator for making certain work performance. That is to say, with the delegation of duty and authority, there must logically go the obligation on the part of subordinates to render an account of their performance. (Further discussion of this topic will be made in Chapter 12 of the volume.)

Principles of Organization. Principles imply generalizations or laws which are capable of universal application. The following are some of the important principles of organization :—

1. *The Principle of Unity of Objective*—The entire organization with all of its parts must be attuned to the realization of enterprise objectives. A hierarchy of objectives exists at departmental, sectional and individual levels of any organization structure, and they are unified and dovetailed for contributing to the accomplishment of common objectives of the enterprise.

2. *The Principle of Division of Work*—Different blocks of activities are to be ascertained and enumerated on the basis of specialization for effective accomplishment of objectives.

3. *The Principle of Span of Supervision*—The limit to the number of subordinates who can be effectively supervised by an executive is to be taken into consideration in grouping and assigning activities to a department.

4. *The Principle of Scalar Chain of Authority*—Every subordinate position in the enterprise must be linked by a line of formal authority to the source of ultimate authority in the organization structure.

5. *The Principle of Unity of Command*—In assigning activities, it is to be seen that subordinates in a specific area always receive orders from one superior only.

6. *The Principle of Balance*—For effective grouping and assigning activities, this principle calls for putting balance and emphasis on all factors and adjusting their conflicting claims through analytical study and objective judgment.

7. *The Principle of Parity of Authority and Responsibility*—This principle implies that the superior in delegating to subordinates is to

see that equality exists between authority and responsibility. This principle becomes more significant in meaning when it is stated that duties, powers and obligations of subordinates must be correlated with one another in the act of delegating.

8. *The Principle of Authority Level for Decision Making*—Authority exists at different levels for decision making and only those decisions which cannot be taken at a lower level should be pushed upward.

9. *The Principle of Leadership Facilitation*—Every managerial position should be arranged in such a way as to facilitate the growth of leadership capacity.

10. *The Principle of Continuity*—Organization must evolve means for the continuous existence of the enterprise through redefining objectives, adjusting plans, reorganizing structural components and developing future managers in the context of ever-changing environment of the business.

Significance of Organization. The significance of organization lies in its importance. Organization adds effectiveness to human efforts in any enterprise. It strives for securing the maximum result by the use of least efforts. In a number of ways, organization results in enlisting the best contribution of human energy. *First,* promptness and certainty in work performance are assured by the allocation of fixed duty to different employees who are held accountable for completing their jobs in time. *Secondly,* because of the system of accurate determination of job requirements and man specifications, right persons can be placed in right positions and full day's work can be assigned to all persons. That is, men with greater abilities and pay are not allowed to waste their time in minor jobs. Benefits of specialization can be fully reaped in the enterprise. *Thirdly,* since work facilities and managerial communication are readily available, employees are not required to sit idle for want of instructions, orders or guidance. *Finally,* as co-ordination between two activities of the enterprise or between two jobs of employees is maintained by managers, all delays, confusions and overlappings are avoided in the performance of work.

Organization paves the way for expansion and growth on the part of business enterprises. With the establishment of large-scale enterprises, all personal contacts between employers and employees have been lost. But still, an effective touch between them is maintained through the authority relationships of different managerial positions in the enterprise. Organization, as a structure of duties, powers and authority relationships, provides the arteries and nerves for the purpose of employer-employee communication. The organization structure supplies the two-way channel of communication for sending managerial

orders, instructions and other decisions downward as well as for conveying employee reports, complaints and grievances upward. Giant enterprises are the direct outcome of organizing work in business.

Organization prevents the growth of dishonesty in many forms and permits the human beings to develop their capacity to the full extent. Whether in matters of money or in matters of human efforts, organization puts an effective check upon the violation of moral law. Moreover, clear-cut assignment of duties enables employees to make adequate performances with freedom and initiative and to keep off the evils of personality politics. Organization facilitates the formation of informal associations among members for permitting them to derive personal contentment and social satisfaction from the work. Again, organization provides the scope for training, testing and developing managers under the programme of executive development.

MEANING OF MANAGEMENT

Management is the activity for getting things done by others. For getting the work of an enterprise completed through the efforts of other people, it becomes necessary to guide, direct and unify human efforts towards the fulfilment of certain common goals. Management represents that skill or activity which directs, regulates and integrates human efforts in the discharge of all operations required for an enterprise. In popular parlance, management is taken to mean the persons who assume the functions of management. Strictly speaking, management is a functional concept and does not include the persons who practise management. Persons assuming management functions are called managers, executives, and even administrators in some cases.

Management plays a pivotal role in the operation of business enterprises. A business is constituted by several elements, *viz.*, materials, men, money, machines, methods, markets and management. Of these seven M's, management stands at the apex of the enterprise pyramid, and it determines and controls all other factors of business operation. As a result, it is the capacity of managers which accounts for the ultimate success or failure of the concern. In most cases, however, a group of managers is found to be engaged in management functions. Managers act mostly as a team with definite jurisdictions of work and perfect co-operation among them. Accordingly, managers are also referred to as management team, management personnel or management members. Uninformed persons erroneously refer them as *the management*.

Management and Organization. Management functions fall into four broad categories—planning, organization, direction and control. The directing function is, however, known by various names like com-

mand, motivation, execution or actuating. It is clear therefore that organizing is one of the functions of management. An organization structure emerges from the organizing efforts of management members. The organization structure consists of duties, powers and obligations of different managerial positions in the enterprise and of interrelations among them through the authority delegation of the organizing work. Thus, the organization structure is no more than the framework of management personnel. But organization is an important function of management. Without organizing, other managerial functions of planning, directing and controlling lose much of their forces. The relation between management and organization can be better indicated by drawing one analogy with the human body. Management represents the entire body, while planning is the brain, organization constitutes its nervous system, direction makes up its respiratory organs, and control stands for the human mind.

Management and Administration. Management is a kind of activity for getting things done by others. Management is necessary for running all those institutions in our society which require group efforts. Unless group efforts are directed and controlled towards a common purpose, no satisfactory accomplishments can be made in any organization. Viewed from this context, management has a universal application for the operation of all social institutions, whether they are business or non-business ones, and it is to be found everywhere as a distinct, separate and dominant activity. This distinct activity is commonly called "management" in business enterprises and "administration" in non-business enterprises. Whatever labels might be used, the stuff is composed of the same materials in both the cases.

A line of demarcation was drawn in the past (and even today it is drawn by some) between administration and management in the sphere of business. Administration was used as policy-making functions in business enterprises, while management was taken to mean policy-executing functions. In other words, planning and organizing were the functions involved in administration, and directing and controlling functions were the special concern of management. All recent studies have proved this distinction to be false and misleading. It is management which includes all the four functions of planning, organization, direction and control. All managers, irrespective of their levels and ranks, are to discharge these functions. In fact, these functions provide the identifying mark by which a manager can be distinguished from non-managers.

Levels of Management. To deny the distinction between administration and management is not to suggest that there are no levels of

management. The upper level of management can be sharply differentiated from the rest of them. The upper level is currently denoted by the term "top management". The top managers delegate duty and authority to other managers who become subordinates to the delegators. As delegation may be required for two or more times according to the size of the business, there may exist intermediate management, middle management and supervisory management. The lowest level of management is made up of supervisors, foremen and charge-hands, since they also assume the functions of planning, organization, direction and control in differing degrees. In the company set-up, top management comprises the board of directors and the managing director or other chief executive, and middle management is composed of departmental and sectional managers.

Importance of Management. In a sense, management represents the entire business. It guides, directs and regulates all other resources and facilities of the enterprise. It is the capacity of managers that determines how much accomplishment would be made by a business. Management is the most activating element and the dynamic force in the enterprise. Through the adoption of enlightened forecasting and far-sighted planning, it makes the future events favourable for the enterprise. Management provides a competitive edge to the enterprise and forges ahead through innovations and imaginations.

Management holds the key to greater productivity by inspiring and influencing the human resources of the enterprise. It adds a real plus value to the operations by enlisting a little extra energy from each person. By providing a unity of purpose and efforts, management secures the best contribution of human energy and pulls up the groups of personnel to a higher level of performance. Management has thrown a challenge to the findings of other social sciences in respect of industrial development and economic betterment of any society. Through transmuting resources rather than transforming them to greater productivity, management has demonstrated that the job can always be betrayed by the way the job is done and that the capital formation is secondary to skill formation for securing economic growth.

FUNCTIONS OF MANAGEMENT

As an activity process, management involves four fundamental functions, *viz.*, planning, organization, direction and control. To this list of four basic functions, three other functions, *e.g.*, staffing, motivation and co-ordination are mooted in the management circle.

1. *Planning*—Planning involves choosing between alternatives for drawing up a programme of action. The programme of action is pre-

pared with timing and strategy considerations through the help of individual plans like policies, procedures and methods focussed on objectives. Planning is always based on facts and information collected from proper premising and forecasting. A full-blown programme contains answers to all queries like what, how, where, when, why and who relating to the work.

2. *Organization*—Organization provides the mechanism for purposive, integrated and co-operative action by two or more persons in any enterprise. Organization entails division and grouping of the total activities into units, subunits and jobs as well as combination of such activities into an integrated whole. Organization has two aspects, *viz.*, technical and social. The technical aspect is concerned with duties, powers and relationships of different managerial positions, while the social aspect is related to the personnel who are placed in jobs.

3. *Direction*—Direction calls for guiding, overseeing and inspiring the personnel at work for making better performances. Leadership, communication, supervision and discipline are the means available in direction for getting the work done by people. Planning and organization are mere preparations for work performance and the real work begins from the directing function of management. Direction is mostly concerned with motivation and human relations.

4. *Control*—Control is to see that performances tally with plans. As Fayol put it, control calls for "verifying whether everything occurs in conformity with the plan adopted, the instructions issued and principles established." Setting standards, making evaluation and taking corrective actions are the three steps involved in controlling. The modern system of control has undergone a profound change and it has become forward looking in character and employee centred in application.

5. *Staffing*—Staffing has been made a distinct function of management by separating the social aspect of organizing from its technical aspect. Staffing implies the systematic approach to the problem of selecting, training, motivating and retaining managerial personnel in any enterprise. Staffing is preceded by management manpower planning and is followed by the executive development programme.

6. *Motivation*—Motivation calls for creating the will-to-work in the minds of personnel. For better accomplishment, the will-to-do must precede the actual doing. With the growth of trade unionism and social consciousness, the need for and importance of motivation have become urgent. Although other functions of management have some contributions toward motivation, it is primarily secured by direction in a number of ways.

7. *Co-ordination*—Co-ordination involves unification and integration of group efforts for the achievement of common objectives. The

earlier concept of co-ordination as a separate function of management has been discarded nowadays. It is now regarded as the sum total of management, the heart of management or the essence of management. Co-ordination is secured through all functions of management and it has become the blending and harmonizing factor in all activities and operations of the enterprise.

NATURE AND SIGNIFICANCE OF CO-ORDINATION

Co-ordination is the integration, unification or blending of all activities and efforts in any enterprise for the accomplishment of common objectives. Co-ordination is regarded nowadays as the essence or heart of management functions. It is an all-inclusive concept in management, summarizing the end result of planning, organizing, direction and controlling functions. It is through this co-ordination that management creates a result greater than the sum total of individual and isolated efforts.

Co-ordination and co-operation do not mean the same thing. Co-ordination includes co-operation plus something else. Co-operation simply means that two or more persons are associated voluntarily in the performance of some work through collective efforts. But it has no bearing with time, amount and direction dimensions in group efforts. In contrast, co-ordination implies the application of requisite amount of group efforts in the right time and at the right direction through deliberate executive action. This type of composite and integrated group efforts results in teamwork and acts as a creative force.

Co-ordination, as a blending factor in all activities and efforts, is to be exercised both within and outside the enterprise. Inside the enterprise, the individual activities, sectional activities and departmental activities are co-ordinated towards the realization of some common goals. Beyond the enterprise, co-ordination is secured with activities of competitors, suppliers and customers, with the regulatory measures of the Government, with the technological and technical advances of the time, with the condition of national and international economy, as well as with the wishes and wants of consumers, employees and owners. Co-ordination, both internal and external, thus appears to be an all-round activity in management. In one sense, the sole aim of managerial activity is to secure this co-ordination in operations of the enterprise.

Significance of Co-ordination. The significance of co-ordination can be indicated by pointing out its importance. Co-ordination is recognized as the quintessence of management, summarising the end result of managing. Properly co-ordinated group efforts create a result greater than the sum total of individual and isolated efforts. In

addition to this creative force, it ensures unity of direction in the midst of diversified activities and enables the managers to have a panoramic view of the business. It reconciles the impact of internal and external forces on the enterprise and ensures smooth running of affairs.

Co-ordination exercises a strong influence on the personnel. Ambitious managers are not allowed to manipulate the organizational machinery and their empire-building tendency is curbed. It removes the conflict between the personal interest of employees and the general interest of institutions. It reduces the extent of group rivalry and personal jealousy among the personnel and permits them to develop unity of action and orderly operation. As a result, the employees are contented and happy and they secure job satisfaction from the work.

NATURE AND SIGNIFICANCE OF CONTROL

Control is concerned with securing compliance of actual performance with intended performance. The intended performance is indicated through planning in the shape of standards or targets. And control is to see that performances tally with plans. Intended results of both individual performance and organizational performance are established in planning, and control aims at securing such results. After the completion of work, the actual results whether good or bad can never be improved or corrected. Accordingly, control is exercised from the commencement of the work. The work progress is studied step by step for taking necessary corrective action with a view to improving the ultimate results. The system of control has thus three basic steps—standards, evaluation and corrective action. Standards are established through planning, evaluation is effected through personal observation and written reports, and corrective action is taken on the basis of evaluation of work progress.

Significance of Control. As a fundamental managerial function, control follows other functions. Last but not the least important, control affects all other functions of management and is affected in turn by their influence. Control eliminates the risk of non-conformity between the intended performance and the actual performance. Besides this insurance value of control, it provides a check on other managerial functions and points out their weaknesses. It provides the basis for future planning and organizing in the enterprise through the supply of necessary facts and information. By measuring individual performance, it provides also the basis for rewarding, punishing or disciplining the personnel.

Control is conducive to good management practices in a number of ways. The new system of control has permitted top management to extend the degree of decentralization without losing ultimate control

over the enterprise. It motivates the subordinate managers by allowing them to exercise self-control and to enjoy greater freedom. Control facilitates co-ordination by evaluating work progress in terms of quantity, quality, time and cost standards. It maintains a consistent pattern of executive behaviour and action by regulating the use and application of standing plans. In addition to the operational aspect, the financial aspect of business is thoroughly checked and regulated by control.

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 1 : NATURE & PURPOSE OF BUSINESS

1. Discuss the nature of business activities and explain the interrelationship between industry and commerce.

2. What do you mean by commerce? State the role of trade in commerce.

3. What are the broad divisions of industry? Divide manufacturing industries into some logical groups.

4. How can you classify commercial enterprises into distinct categories? Explain their nature fully.

5. What are the different types of service enterprises? Do you agree with the view that professional services do not fall within the ambit of business?

*6. "Profit can be no more the objective of a business than . . . eating is the objective of living". In the light of this statement, explain the motives for, and objectives of business activities.

*7. Do you think that present-day circumstances compel the business enterprises to temper their profit motive with social responsibilities? What are those social responsibilities? Discuss them fully.

*8. Analyse and explain the features common to all business enterprises.

9. Make out a case explaining the importance of a theoretical study of Business in the present era.

10. Explain that Business is a more practical and useful social science than many other behavioural sciences like Economics, Ethics and Political Science.

CHAPTER 2 : SIGNIFICANCE OF ORGANIZATION, MANAGEMENT & CONTROL

11. What do you mean by organization? Discuss the process and principles of organization.

*12. Discuss the significance of organization in modern business.

13. What is management and how does it differ from organization and administration?

*14. Explain the nature and importance of management.

*15. Discuss the functions of management.

*16. Explain the nature and significance of co-ordination.

*17. Discuss the nature and significance of control in modern business.

PART TWO—BUSINESS ORGANIZATION

CHAPTER 3

OWNERSHIP FORMS OF BUSINESS

A business may be owned by one person or a group of persons. When the business is owned by one person, it goes by the name of sole proprietorship, individual proprietorship, or simply proprietorship. Barring sole proprietorship, all other businesses are owned by a group of persons with varying number of owners. Group ownership or joint ownership is to be found in partnerships, companies, co-operatives and other like forms of businesses. These are primary forms of business ownership in which one or more owners are associated with a specific enterprise. But when two or more primary forms are combined together to establish a new business, some other secondary forms emerge from the process of combination. A number of secondary forms like pools, cartels, trusts, holding companies, mergers, amalgamations, etc., are to be witnessed in the business world. (These secondary forms will, however, be discussed in Part Four of the book.)

Ownership is a legal concept and is protected by the law of the land. Ownership comprises a "bundle of rights", and the size of this bundle is fixed by law according to the nature and extent of ownership. For this, the ownership forms are also referred to as legal forms of business. Usually, ownership carries with it the power of control and the authority of management. However, this right of control and management may be limited by legislation and rule-making powers of the Government. As for example, the Indian Partnership Act of 1932, the Companies Act of 1956, and the Indian Co-operative Societies Act of 1912 are evidences of restriction on ownership rights.

Besides these ownership forms of business, there are structural forms which arise from the organizing function of management. Obviously, State enterprise cannot be divided from the standpoint of ownership; but this lack of divisibility does not imply that all State enterprises are of one type or form. There are considerable differences in the working of different State enterprises. It is the operating organization or structural forms which provide the basis from which a distinction can be drawn between two such enterprises. Even in the private sector of economy, structural forms exist side by side along with the ownership forms. As we have seen earlier, ownership forms provide the organ of action; but for the playing of organ, determination of organization

structures or structural forms becomes necessary. (These structural forms have been discussed in Chapter 12 of the volume.)

THE SOLE PROPRIETORSHIP

The individual proprietorship is a business unit which is completely owned and controlled by one person. From the very dawn of our civilization, this form of business has been in operation, and even today it has remained as much useful as it was earlier. Being the oldest of all forms, it is still the most common form of business organization. As it is easy to establish, simple to operate and free from all regulations, the proprietorship provides the greatest facility to many persons for entering into business.

This business has no separate legal existence apart from the proprietor who owns it. The proprietor and his business have one personality, since this business is looked on in law as a kind of property in the hands of the owner. Consequently, the total benefits and burdens, rewards and risks of this business are entirely assumed by the proprietor. If he can grow a prosperous business, he alone enjoys the fruits without a claimant thereof. At the other extreme, if his business fails for any reasons, whether internal or external, he alone is held responsible for all debts and obligations that may arise from such business failures. As proprietary business is regarded as a kind of owner's property, the whole of his private property in other kinds is liable for the satisfaction of business debts. This is what is known as unlimited liability of the proprietor.

In a sense, the greatest merit and the greatest defect of this business stem from its unlimited liability feature. Unlimited liability is a source of strength to proprietorship, because it drives the proprietor to act with vigour, initiative and resolute purpose for avoiding the crushing burden of business failures. On the contrary, unlimited liability appears as a serious weakness of proprietary concerns in those cases where business fails for external reasons. The business may fail for natural disasters, kicks of the monopolist and other like external causes over which the proprietor has no control ; and yet, he is not relieved of this unlimited liability.

Advantages. As compared with other forms, the advantages of proprietorship may be listed as follows :

1. *Facility of formation*—In the absence of legal formalities and Government regulations, it offers the greatest facility of business initiation. The business comes into existence on the very decision of the proprietor to set it up without any expenditure of time, money and energy.

2. *Managerial motivation*—The principal motive for business activities is profit making. Proprietorship is the only form in which rewards and efforts are perfectly matched and they go hand in hand. For his enjoyment of the entire profits, the proprietor is inspired, induced or motivated to apply the best of his ability and judgment in running the business and to conduct its operation with uncommon zeal and untiring efforts.

3. *Absolute control*—Since the proprietor has the exclusive right of control over his business, he can guide and direct its affairs as he pleases. Consultation with co-owners or approval of others being unnecessary, he can make decisions with such promptness and boldness as are not possible in other forms. Furthermore, the proprietor is absolutely free to make plans and policies and to execute them according to his own thinking. He can avail opportunities or avoid crises as he deems fit without being accountable to others.

4. *Secrecy of business*—Secrecy of business methods and conditions is an element of strength in the business world. Secrecy provides the owner with a competitive weapon and enables him to go ahead over his rivals. The extent of secrecy which can be maintained in proprietary concerns is not practicable in other forms.

5. *Flexibility in operation*—The proprietory business can be adapted and adjusted to meet the needs of changing time and situations. Changes, rather constant changes, are the rule in business, not an exception. The dynamic character of business activities makes the proprietorship an ideal form because of its capacity for absorbing changes.

6. *Personal relations with customers and employees*—Since the size of the business is usually small, and since the owner enjoys the entire profits, the proprietor attempts to maintain a close touch with customers and employees. Individual attention to customers results in increased sales, and direct supervision of employee activities brings in cost reduction. As a consequence, the effect of reduced costs and increased sales is reflected on the expanding volume of profits.

7. *Way of life*—Proprietorship offers a way of life for securing a means of living to those persons who do not want to serve others. It provides business careers to many persons of small means. Many other desires of human beings like creation of something new or worthwhile, pride in accomplishments, or freedom of action are fulfilled through this form of business.

Disadvantages. The disadvantages of proprietorship centre round the limited resources, both material and mental, of the proprietor, and they may be listed as follows :

1. *Limited financial resources*—The amount of capital and credit which can be supplied by one person is too small to meet the needs of

a growing business. Evidently, the proprietor cannot approach the investors for providing him with necessary funds that he may require. Even when the proprietor is a rich man, he is not likely to invest large funds in this business because of its unlimited liability.

2. *Unlimited liability*—The proprietor has to bear the entire financial liabilities and risks of his business. And this risk may run to the extent of all what he owns. As all the property, business and other valuables may be taken over by creditors for the satisfaction of their debts, this form is not conducive to normal business operations which are inherently risky in nature.

3. *Singleness of responsibility*—The managerial responsibility is assumed by one person with nobody else to advise or assist him. However competent the proprietor may be, there are definite limits of skill, judgment and ability on the part of one man. Consequently, results of the business become as good as the capacity of the man warrants. This absolute reliance on the ability of one man may lead to the ultimate ruin of the business.

4. *Uncertainty of duration*—Continuous existence and operation over a long period is a condition precedent to the success of business. Market is developed over a period through the creation of goodwill. But proprietorship has no certainty for this enduring existence. It may abruptly come to an end with the death or physical incapacity of the owner.

5. *Restricted growth*—There are strict limits beyond which this form of business cannot grow. Growth is the normal rule of life ; a business enterprise, as a living organism, is bound to grow in size unless it is deformed or diseased. There are two deformities or deficiencies of sole proprietorship, *viz.*, limited capital and limited capacity, which arrest its normal growth. It is idle to expect that a proprietor will have specialist knowledge in all business functions like purchasing, selling, financing, accounting, etc.

Evaluation of Proprietorship. · In number of business concerns, proprietorship constitutes the single largest class of business establishments in all countries of the world. But their number is out of proportion to the amount of business transacted by them. As to the amount of business done by different forms, proprietorships lag far behind companies which have undisputedly assumed leadership in the business world. Nevertheless, the ease of formation, simplicity of operation and freedom of action have made it the common form of organization in small business. Professional firms, household and personal-service enterprises, retail trading and small manufacturing concerns are mostly organized on the basis of sole proprietorship. Beyond these spheres, unlimited liability along with insufficient capital acts as a brake for its

going into big and risky ventures. Put in short, where business activities are of simple nature and do not require a large amount of capital, this form of business is likely to thrive.

THE PARTNERSHIP

The partnership business is very often an outgrowth of proprietary concerns. Being unable to cope with the needs of a growing business, the proprietor finds a way out of that situation by taking outsiders as his business associates who provide him with additional capital and mental resources. When several persons set themselves up in a business with common ownership and management under an agreement, the business takes the name of partnership.

The Indian Partnership Act, 1932, defines partnership as "the relation between persons who have agreed to share the profits of a business, carried on by all or any of them acting for all". Owners of the partnership business are individually known as 'partners' and collectively a 'firm' and the name under which the business is carried on is referred to as 'firm name'.

Basic Features. The basic or salient features of the partnership organization can be stated by analysing the statutory definition in the following way :

1. *Contractual relation*—The relation that exists between partners is said to be a contractual or agreed one, not natural relation arising out of mutual love and affection. Two offshoots of this contractual relation become apparent ; (*i*) a minor, who is not competent to make contracts, can never become the partner of a firm, although he may be admitted to its benefits in some cases ; and (*ii*) any business set up by persons with natural relation, *e.g.*, a father and his sons or members of a joint Hindu Family, is not raised to the status of a partnership concern.

2. *Two or more persons*—Obviously, the minimum number of partners must be two, otherwise the status of the business will be relegated to that of an individual proprietorship. The maximum number of partners has been limited to 10 in banking business and 20 in other businesses by the Companies Act, the Partnership Act remaining silent over this point. Section 11 of the Companies Act provides that an unregistered association, company or partnership having more than 20 members (or 10 members in the case of banking) is to be registered under the company law. Otherwise such body of persons would become illegal associations and every member thereof would be liable to a maximum fine of Rs. 1,000.

3. *Participation in business*—The partners must actually participate in a business venture rather than their association or combination

for the holding of some property in joint ownership. As business implies certain activities on the part of owners relating to the production and sale of goods or services, mere holding of property in joint ownership is not sufficient for constituting a partnership business. Unless the co-owners utilize their property in activities that are recognized as business, no partnership can exist between the co-owners.

4. *Sharing of profits or losses*—The purpose of the partnership business must be profit making, not philanthropic or charitable one. No profit can be shared unless there are agreements to make such profits. Sharing of losses is a corollary of sharing profits. In other words, the motive of the partners in forming the partnership business has to be profit earning, and the absence of this motive will take out any business from the list of partnership.

In one sense, this feature has no real significance, because the idea of profit is deeply embedded in the concept of business activities. To be sure, profit provides the primary motive to businessmen for their engagement in business. Furthermore, the Partnership Act prescribes a lengthy list of circumstances under which certain specified persons do not become partners for their participation in profit of the business. Since partnership is based on a strictly personal relationship between persons, and since profit sharing among owners means division of the net profit, this elaboration of circumstances also appears to be redundant.

5. *Common management*—Ownership of property usually carries with it the right of management. For business ownership relating to a partnership concern, this right of management is emphasized by the statement that partnership can be managed by all or any of them acting for all. Wherever the partner's right of management is taken away by restrictive agreement, the existence of partnership will be wanting in the situation. Whether this right is actually exercised or not by an individual partner is a different question. To meet the requirements of law, the right should not be destroyed by any agreement.

Subsidiary Features. Besides these basic features which are called elements of partnership, there are some other features that flow from contractual relationship of partners. *In the first place,* partners of a firm are jointly and severally liable for all debts and obligations of the business to an unlimited extent. This joint and several unlimited liability means that when partnership property is insufficient for meeting the debts of creditors, they may look to the partners' private property for the satisfaction of their claims. For satisfying their claims, the creditors may even realize the entire amount of their dues from one of the partners. The paying partner is, however, entitled in law to obtain ratable contribution from his co-partners. *Secondly,* there exists the

system of general agency in partnership. Every partner is a general agent of the firm as well as of his co-partners. It follows therefore that a contract made in the firm name or an act done in the ordinary course of business by any partner would be binding on the part of the firm and of his co-partners. Such an act or a contract is deemed to be the act of the firm, and the authority so exercised by the partner is regarded as his implied authority stemming from the agency right. *Thirdly,* a partner cannot transfer his interest to an outsider so as to make the transferee taking his place in partnership without the unanimous consent of other partners. This restriction on transferability of interest is based on that legal principle which prohibits a delegated agent from delegating his authority. Being an agent himself, a partner of the firm cannot delegate his authority to the outsider. *Finally,* partnership contracts belong to the class of contracts which rests on utmost good faith. Partners must be just and faithful to one another, and they must render true accounts and full information relating to the operation of partnership business. In other words, as each partner occupies a position of trust, he is both legally and morally bound to be honest in his dealings with other partners.

FORMATION OF PARTNERSHIP AND ITS LEGAL ASPECTS

Like the sole proprietorship, the partnership also is fairly easy to establish. As soon as an agreement is reached between parties over the important points and the necessary capital is brought in, the partnership business is ready to start functioning. Usually, the mode of sharing profits and losses is decided by partners through the establishment of some fixed ratios or percentages. If nothing is settled by the partners over this point, profits and losses are shared equally by all members of the firm, irrespective of the fact of unequal capital contribution or even no contribution on the part of some partners.

No interest is generally allowed on capital contributed by partners, because contributors thereof are entitled to a return on such capital investment by way of profits. But investments made by a partner beyond his agreed capital contribution are treated as loans which must earn some interest. This payment of interest on such loans is based upon two considerations ; first, the investor does not get any extra profit as compensation for this additional investment ; and secondly, some inducement by way of interest is necessary for attracting funds in business. The Partnership Act prescribes a maximum rate of interest at 6% p.a. on such loans. Within this permissible maximum, any rate of interest may be agreed upon by the partners. In the absence of any agreement on this point, the maximum rate is to be paid on loans advanced by partners.

Partnership Deed. The partnership comes into being through the making of an agreement between partners. Like other agreements, the partnership agreement may be either verbal or written in character. Although verbal and informal agreement is as much binding as the written and formal agreement, yet it is desirable that important terms and conditions of partnership are put down in writing for avoiding future troubles and misunderstandings among partners. Disputes and disagreements may crop up among the partners over the contents of verbal agreement. To make the terms of agreement certain and definite, the partnership agreement is very often placed on record by way of writing. Such written agreement is called Articles of Partnership or Partnership Deed. For purposes of authenticity, the partnership agreement in writing is required to be stamped. The partnership agreement, containing matters for determination of mutual rights and liabilities of partners, varies from case to case. While no two agreements can be identical in all respects, still the following may be stated as the common points found in almost all agreements :

1. Date of agreement and principal place of business.
2. Firm name and names & addresses of its partners.
3. Nature of the business and its duration, if any.
4. Amount and mode of capital contribution by each partner.
5. Division of profits or losses.
6. Salary and withdrawal arrangements.
7. Basis and rates of interest or commission calculations.
8. Allocation of managerial responsibility among partners.
9. Valuation of goodwill on death, retirement or introduction.
10. Grounds for dissolution and consequent settlement of accounts.
11. System of keeping books and bank accounts.
12. Procurement of additional capital and introduction of partners.
13. Arbitration procedure for settling disputes among the partners.

Rights and Obligations of Partners. Unless otherwise provided in the agreement, the rights and obligations of partners are as follows :

1. The partners have to contribute capital equally and to share profits or losses equally among themselves.

2. A partner does not get any interest on capital investment, but he is entitled to receive six per cent interest per annum on any advance or loan.

3. The firm is required to compensate every partner in respect of all such payments and liabilities as may arise from the ordinary course of business or from avoiding the loss in emergency.

4. Every partner has the right to make inspection and to take copy of account books which are to be kept in a common place.

5. Every partner has the right to take part in managing the business, but he is not entitled to receive any remuneration for such management.

6. Ordinary matters can be decided by the majority consent, but important changes cannot be introduced without the consent of all partners.

7. Admission of a new partner or removal of an existing partner cannot be effected without the consent of all partners.

8. Irrespective of changes, the rights of partners continue to exist during the continuance of partnership.

9. Every partner is jointly and severally liable for all debts and obligations of the partnership business.

10. Partners must be just and faithful to one another. Every partner must render true accounts and full information concerning business to other partners.

11. The partnership business must be operated to the maximum common benefit of all partners who are supposed to work diligently and honestly for the firm.

12. A partner cannot make any secret and personal profit. On the contrary, he must compensate the firm for any loss caused by his wilful negligence.

13. Outgoing partners remain liable for all such debts as are incurred before their retirement, and incoming partners are relieved of all liabilities arising before the time of their admission.

Registration of Firms. Registration is not at all necessary to constitute a partnership, because partnership comes into existence as soon as an agreement is reached between the partners. But according to the provisions of the Partnership Act, certain rights of litigation are not available to the unregistered firms, as distinguished from the registered firms which enjoy such rights. Accordingly, all important and reputed firms are rather induced to get themselves registered for obtaining the protection of law in realizing their dues and interests. Each State Government appoints a Registrar of Firms with whom firms are to be registered by sending a statement of particulars in the prescribed form along with the requisite fee of rupees ten or thirty, as the case may be. Any important change relating to the firm must be notified to the Registrar of Firms so as to enable him to maintain an up-to-date record in his register. This register, containing details of all registered firms within a particular State, is open to all for inspection on the payment of requisite fees.

Both the unregistered firm and its members suffer from certain disabilities. These disabilities are (*a*) that the unregistered firm cannot enforce its claim against any third party for recovering a sum exceeding

rupees one hundred, and (*b*) that the partners of an unregistered firm cannot enforce their rights, whether arising from the partnership agreement or from the Partnership Act, against the firm as well as against the co-partners in a court of law. However, there are some rights like the right to sue for the dissolution of the firm, for the accounts of a dissolved firm, or for the realization of the property of the firm under dissolution, which are not affected by this registration provision.

CLASSES OF PARTNERS AND PARTNERSHIP

Kinds of Partners. Partners are classified variously from the standpoint of their business interests, public liabilities as well as of managerial responsibilities. The following are the different classes of partners :

Active or managing partners—The partners who take active part in managing the business are called active, managing, or even general partners. Their association with the firm becomes well known to the general public, and particularly to the persons making transactions with the partnership.

Dormant or sleeping partners—The partners who do not take part in actual management of the business and who are not usually known to the outsiders are referred to as dormant, sleeping or silent partners. That is, they are inactive or passive in regard to managerial responsibilities, and their identities are not known to the public.

Secret partners—Secret partners stand halfway between active partners and sleeping partners. They participate in management of the business like active partners, but at the same time they prefer to work behind the scenes.

Nominal partners—As the term implies, nominal partners exist in name only, not in fact. A person who in reality is not a partner, and as such, who is not entitled to the benefits of a partnership business, may be regarded as a partner in the eye of the law for undertaking partnership liabilities. Outsiders become nominal partners by permitting a firm to use their name and credit for the purpose of partnership business. In particular, outsiders become nominal partners through the principles of (*a*) holding out and (*b*) estoppel. In the case of holding out, when an outside person is held out or represented to the public as a partner of some firm and he does not disclose his true relationship with the firm even after that representation or holding out, the outsider becomes liable as a nominal partner for all debts that may arise from such representation. Here the silence of the outsider amounts to eloquence. In the case of estoppel, an outsider may be estopped in law from denying the role which he may assume by false representation to the public. For misleading others, when a person represents himself

to be a partner of some firm, whether by words of mouth or by conduct, the person making false representation becomes liable as a nominal partner for partnership debts which arise from that representation.

Incoming partners—Persons joining an established firm either with the consent of its partners or in accordance with the terms of partnership deed, are called incoming partners. The incoming partners are exempt from all liabilities arising before the date of their joining, unless they willingly assume such liabilities with the consent of creditors. They are usually required to pay premium money as compensation to the existing partners for their act of foregoing some share of profit in favour of the newcomers.

Outgoing partners—Partners retiring voluntarily without causing dissolution of the firm are referred to as outgoing partners. Usually, outgoing partners are liable for all such debts as are incurred before their retirement ; they are also liable for all those obligations which may arise from transactions remaining unfinished at the time of their retirement. To avoid future liability, they must give proper notice of their retirement to the creditors. However, they may be made free of all such liabilities by the consent of creditors and other partners.

Limited partners—They are an entirely different class of partners to be found in the case of limited partnership only, not in general partnership. The position of the limited partners has been dealt with separately in connection with the discussion of limited partnership. Suffice it to say here that liability of limited partners is limited to the value of their capital contributions in return for their sacrifice of many partnership rights.

Minors in the role of partners—The persons of minor age can never become partners because of their incapacity for making contracts ; but they may be admitted to the benefits of a firm with the consent of all its partners. Such minors are entitled to their share of profits as may be given to them and to have access to the accounts of the firm for inspection or copy purposes. But they are not personally liable for the debts of the firm nor their private property is liable to attachment by creditors of the partnership. At best their interests in partnership may be taken over by creditors in settlement of debts. On their attaining majority, they are to decide within six months whether they will become regular partners or will secede from partnership. The choice in either way is to be intimated through a public notice within this period ; and failure to give such notice would make them partners of the firm. Once they are taken in as partners, they become personally liable like other partners for all debts and obligations of the firm accruing from the date of their admission to its benefits.

Other partners—Sometimes, members of a firm are called by the names of *junior* and *senior partners*. The use of such terms has nothing

to do with the age of partners ; they rather imply partners with larger or smaller financial interests in the partnership business. As it happens, partnership contracts confer some special powers upon the senior partners and deny certain rights to the junior partners. In addition, dormant partners may become *partners in profit only* by their agreement with other partners to the effect that they will share profits of the business, not its losses. However, despite their avoidance of loss sharing, they remain as much liable to third parties as other partners are.

Kinds of Partnership. The partnership business can be broadly divided into two groups—general partnership and limited partnership. The general partnership can again be subdivided into three kinds, *viz.*, (*a*) partnership at will, (*b*) particular partnership, and (*c*) joint venture, a variant of particular partnership. Different kinds of general partnership may be briefly discussed in the following way, deferring the study of limited partnership to subsequent pages.

Partnership at will—When a partnership is formed for an indefinite period, *i.e.*, no period is mentioned in the agreement as to the continuance of partnership, it goes by the name of partnership at will. The partnership formed for a definite period or venture and continued even after the completion of that period or venture, also takes the character of partnership at will. The partnership of this kind can be dissolved at any time by a partner through the issuance of a notice to that effect.

Particular partnership—The particular partnership means that partnership which is established for a fixed period or for the completion of a definite venture and automatically comes to an end with the expiry of the period or the venture, as the case may be.

Joint ventures—The joint venture is organized for the completion of a specific thing in a specified time. The scope of the joint venture is limited to a particular purpose and relates usually to some speculative undertakings. The power of management is generally delegated to one of the participants and he remains accountable to other members. Like the partners in a general partnership, the members of the joint venture are personally liable for its debts and obligations. Members of the joint venture do not enjoy such general agency rights and extensive powers as are available in the case of general partnership. To make the acts of a member binding on the part of all, the member should have express authority to perform such acts in all joint ventures. The existence of the joint venture is not affected by the death of a member, and no member is allowed to secede from the venture before its completion. On the termination of the venture, the net proceeds are divided among the participants according to some predetermined ratios.

DISSOLUTION AND LIQUIDATION OF PARTNERSHIP

The Indian Partnership Act makes a distinction between the dissolution of partnership and the dissolution of firm. The dissolution of partnership may result in the continuance of the same business on the part of a reconstituted firm. Since partnership is an agreement between partners, and since dissolution implies ending or termination of something, the dissolution of partnership is to be taken as the abandonment of the existing agreement. Partnership agreements are very often replaced by their new varieties on the introduction, retirement or death of a partner ; the business of the firm is not affected by the changing of such agreements. That is to say, the dissolution of partnership does not amount to the liquidation of partnership firm and its business. But when the dissolution of firm takes place, the existence of partnership business is affected because of the withdrawal of all partners. For clarity of understanding, the dissolution of firm has been dealt with under the title of "liquidation of firm".

Dissolution of Partnership. The Articles of Partnership usually indicate the circumstances under which a partnership business may or may not be liquidated on the dissolution of partnership, *i.e.*, on the termination of an existing agreement. Subject to the provisions contained in the Articles of Partnership, the following causes of dissolution of partnership do not generally lead to the liquidation of firm. The partnership is dissolved (*a*) on the death, retirement or insolvency of any partner, (*b*) on expiry of the term when it is constituted for a fixed term, and (*c*) on the completion of the venture when it is formed for undertaking one or more ventures.

Liquidation of Firm. The liquidation of partnership business or the dissolution of firm takes place in the following circumstances : (1) By the mutual consent of all partners or in accordance with the contract between partners, (2) by the insolvency or death of all partners, or of all partners but one, (3) by the happening of any event which makes the business of the firm an unlawful occupation, (4) by the written notice from any partner to all other partners communicating his desire to dissolve the firm when it is a partnership-at-will, and (5) by the court decree over law suits of a partner on the grounds of—

a. The insanity of a partner.
b. The permanent incapability of a partner to act as such.
c. The wilful misconduct of a partner affecting the operation of the business prejudicially.
d. The persistent and recurring breaches of the agreement by a partner making the operation of partnership business rather impracticable.

e. The transference of a partner's entire interest to a third party or the sale or charge of such interest for the recovery of land-revenue from the partner.

f. The profitable operation of the partnership business becoming an impossibility for any reason.

g. The dissolution of the firm appearing just and equitable in the eye of the law for any other reasons.

ADVANTAGES AND DISADVANTAGES OF PARTNERSHIP

Advantages. 1. *Facility of formation*—Like the sole proprietorship, the partnership is also comparatively free from legal restrictions and Government regulations. It can be formed easily without any expense and any formality. Money and efforts required for organizing a partnership are almost negligible as compared with the formation of companies.

2. *Greater capital and credit resources*—As it permits several persons to pool their resources into a common business, the amount of capital accumulation becomes much higher than what can be contributed by one owner in proprietorship. In addition, the partnership occupies a unique position in obtaining credit from the financial market. Because of its joint and several unlimited liability, the borrowing capacity of a partnership is not limited by the total value of the firm's assets, rather it extends to the worth of aggregate private property of all the partners. As a result, the amount of credit which can be secured by a partnership may be much larger than the amount of actual capital investments in the business. Even the company does not enjoy such a high credit standing as the partnership concerns do.

3. *Combined abilities and judgment*—The partnership combines capital with brains of two or more persons, and thus ensures better management of the business. Combined abilities and judgment, when properly integrated, produce a result that becomes appreciably greater than the sum of all individual capacities. Furthermore, benefits of specialist knowledge and division of labour are reaped in full.

4. *Flexibility in operation*—Since decisions are taken in partnership by two or more persons whose concurrence is necessary in various policies and procedures, it is less flexible in character than a sole proprietorship. But still, the partnership has many elements of strength in managing, financing and reorganizing the business. It can be adapted and innovated to suit the changing business requirements by way of adjusting its objects, membership, capital or methods of business operation.

5. *Matching of ownership with control*—Since the powers of management and control are evenly placed in the hands of those who

own the partnership business, the partners are likely to manage the business with great care, caution and interest. Moreover, the partnership provides a fair correlation between rewards and efforts on the part of owners, and as such the partners are induced to apply the best of their energy and capacity for the success of the business.

6. *Better public relations*—When a number of owners are actively engaged in maintaining cordial relationships with different interested parties in business like employees, customers, suppliers, lenders, neighbouring citizens, etc., the results of such endeavour are invariably mirrored into higher accomplishments and greater profits. The partnership may create such a vast amount of goodwill as to pave its way towards steady progress.

7. *Protection of minority interest*—The minority interest in a partnership is adequately protected by law. Questions of major policy like changes in objects, amendments to the articles of partnership, transfer of interest on the part of a partner or investments of funds in other enterprises, are reserved for unanimous decision of the partners. While important matters are decided by all partners and ordinary matters are settled by the majority vote, yet the majority group can never neglect the opinion of the minority group, not even the opinion of a single partner. Otherwise, the dissatisfied partner may cause the dissolution of the firm, or he may create such situations as to compel the other partners to buy him out.

Disadvantages. 1. *Lack of centralized authority*—The power of management is vested in all the partners. If there is an absence of mutual understanding and co-operation, combined abilities may appear as a curse rather than a boon. Constant opposition and disagreements on the part of partners hamper the partnership business at every stage and may halt it altogether after a short life.

2. *Risk from activities of co-partners*—A partner, being an agent of the firm and his co-partners, can make deals and contracts that would be binding on the other partners. It follows therefore that dire consequences may emanate from the choice of a partner who is either dishonest or incompetent. Briefly, the honest and efficient partner may be required to pay the penalty for follies and vices of other partners.

3. *Instability of business*—The partnership is a very unstable form of business. It may come to an end not only on the death, retirement or insolvency of one single partner, but it may also be terminated by the whims and caprices of a dissenting partner. That is to say, the partnership possesses a precarious life at any point of time and may be thrown out of existence in the near but unknowable future.

4. *Onerous liability*—From the standpoint of liability, the partnership is much inferior to the proprietary concern. Like the proprietor,

the partners are saddled with the burden of unlimited liability. In addition, this unlimited liability may arise from the mistakes and misdeeds of other co-partners. Furthermore, one partner may be forced to pay the entire amount of partnership debts, although he can subsequently recover the shares of his co-partners through law suits.

5. *Non-transferability of interest*—A partner cannot sell his interest to a third party without the consent of all the partners. But this unanimous consent may not be secured by a partner in his personal emergency. As a result, funds invested in the partnership business are blocked or tied up for all practical purposes.

6. *Insufficient capital*—No doubt the partnership provides a means of securing greater capital resources in comparison with the proprietorship ; but its capital accumulations become very often too small to meet the requirements of any large-scale operations. In fact, the liability feature of the partnership deters even the resourceful partners from contributing as much capital as their capacity warrants.

7. *Reduced public confidence*—The absence of legal regulations over the formation of partnership and the lack of publicity relating to its business affairs tend to underrate the prestige and status of this form of business.

THE LIMITED PARTNERSHIP

In order to relieve the burden of unlimited liability of every partner in general partnership, the limited partnership has been evolved as a distinct form of business in the Western countries and in the U.S.A. However, the limited partnership is not a permissible form of business in our country under the existing law of the land. Perhaps the reason for not allowing this form can be traced in the existence of a rival form, *viz.*, the Joint Hindu Family business. It can be pointed out that Joint Hindu Family concern has close resemblance with the limited partnership in many respects and that the *Karta* or the manager of the Joint Hindu Family occupies the same place as the general partner does. Likewise, other members of the family stand for limited partners.

Features. A limited partnership has the following features which differentiate it from the general partnership :

1. It must have one or more 'general partners' who are liable for all the debts and obligations of the firm to an unlimited extent. There must also be one or more 'special partners' or 'limited partners' who are liable only for the amount of their capital contributions. In other words, the liability of a limited partner is limited to the amount of his fixed capital contribution like the shareholders of a limited liability company. Thus, it is a partnership consisting of two different classes

of partners, *viz.,* partners with limited liability and partners with unlimited liability. However, the total number of partners is limited to 20 in ordinary trading and 10 in banking as in the case of a general partnership.

2. A limited partner is prevented from taking any active part in management of the business. He is not an agent of the firm, and as such he cannot make any deals or contracts that would be binding on the firm. But he may inspect the books with a view to keeping himself informed about the affairs of the limited partnership. Also, he may advise the general partners and confer with them.

3. A limited partner cannot withdraw any part of his capital except by undertaking a separate liability for the amount so withdrawn. He cannot transfer his interest to others without the consent of the general partner. But at the same time, the consent of the limited partner is not necessary for the admission of a new partner.

4. The limited partner is prohibited from violating the restrictions on his rights and powers under a penalty of losing the privilege of limited liability and of assuming the liability of a general partner. The name of the limited partner need not be disclosed to the parties making transactions with the partnership and can neither be referred to in the official name of the firm or in any other literature.

5. Every limited partnership must be registered with the appropriate official of the Government. To indicate the extent of liability undertaken by each of the limited partners for the debts of the firm, the individual amount of their contributions is to be disclosed at the time of registration. Failure to comply with the requirement of registration results in treating a limited partnership as general partnership.

6. The retirement, death or bankruptcy of a limited partner does not affect the existence of the firm in the least degree. In the U.K. where this limited partnership is common, it is governed by the Partnership Act, 1890 and the Limited Partnership Act, 1907.

Merits and Defects. So far as merits are concerned, *in the first place,* the limited partnership provides a means of securing larger funds from persons who are not willing to assume the responsibilities and liabilities of the general partners. *Secondly,* this kind of partnership is much to the liking of general partners. The general partner, if he is a man of enterprising ability and business experience, can go ahead with his own plans and ideas without any let or hindrance from the limited partners. *Thirdly,* the limited partnership enjoys a greater stability than general partnership, since the firm is not affected by the death, retirement or bankruptcy of limited partners. *Finally,* besides these typical merits, the usual advantages of the general partnership are within the reach of this kind of partnership.

As against these merits, there are a number of defects of the limited partnership. *First,* the credit standing or credit rating of the limited partnership is much inferior to that of the general partnership, and it may not obtain necessary credit on favourable terms like a general partnership. *Secondly,* the general partner wields much power and control in comparison with his financial stake in the business. Consequently, there is always the temptation on the part of the general partner to misuse and abuse the power against the interests of limited partners. *Thirdly,* the limited partners are placed at the complete mercy of general partners. For this reason, an implicit faith in the honesty and capacity of the general partner is a prerequisite condition for inducing a limited partner to invest funds in such businesses. *Finally,* it has practically no advantage over the company form, particularly a private limited company, except that of a smaller initial cost of business formation.

THE JOINT HINDU FAMILY BUSINESS

The Joint Hindu Family business is a peculiar form of business organization that operates in our country. The extensive use of this form is to be found among the non-Bengali Hindus in India. Basically, it is a business by co-owners of a Hindu undivided estate. As an offshoot of Hindu Law and Hindu customs, it has acquired certain special characteristics that have made it a distinct form of business in India.

It should be clearly understood that no Joint Hindu Family in the technical sense is possible in Bengal and Assam where the Dayabhaga system of inheritance prevails. This joint family is only possible in other parts of the country where the Mitakshara system of inheritance is in operation. Again, the joint family of this type is confined under the Mitakshara system to those persons who constitute the co-parcenary interests.

The significance of co-parcenary interest is that three successive generations in the male line can simultaneously inherit the ancestral property from the moment of their birth in the family and that the subsequent devolution of interest is regulated by the principles of survivorship. The Hindu Succession Act, 1956 has affected the co-parcenary interest to some extent. Previously, female members and their relations were totally shut out from this co-parcenary interest. Under the Hindu Succession Act, any female relative of a deceased co-parcener (male), or a male relative claiming through such female relatives (specified as Class I in the Act), is entitled to get a share of the co-parcenary interests at the time of death of such co-parcener. To be sure, such relatives are not included on the list of holders of co-parcenary interest,

but they are allowed to have some shares out of co-parcenary interests as outsiders.

Three generations next to the holder in unbroken male line constitute a co-parcenary ; and property inherited by a Hindu from his father, father's father and father's grandfather is regarded as ancestral. A son, grandson and great grandson become joint owners of the property by reason of their birth in the family. The property is managed and held by the senior male member or the father as the head of the family. In Hindu Law, a family business is taken as a part and parcel of the heritable property ; it follows therefore that the family business becomes the subject matter of co-parcenary interest. And the rights and liabilities of co-parceners are determined by the general rules of Hindu Law, not by the provisions of the Indian Partnership Act, 1932.

Joint Hindu Family and Partnership. The joint and undivided Hindu Family business has the following characteristics which sharply distinguish it from a partnership business :

1. The membership of the family business is the result of status arising from birth in the family. The majority or minority in age of the members is quite immaterial for the family business, as distinguished from a partnership concern. In addition, the maximum number of members is not limited to twenty or ten like the partnership business.

2. Both males and females can become the partners of a firm, while female members are excluded from the class of co-parceners who constitute any joint family business.

3. This is the only unincorporated form of business association which does not require registration under Section 11 of the Companies Act, 1956, even though the number of members exceeds 10 in banking business and 20 in other businesses. For purposes of enforcing its claims and rights, it does not require registration like a partnership.

4. The business is managed by the *Karta, i.e.*, the manager of the family, and for ordinary purposes of the business, he has the implied authority to obtain loans on mortgages or in other ways. But other members of the family have no rights of management over the family business, and they can neither contract any loans on mortgages that would be binding on the part of the joint family property.

5. The liability of all members of the family, except the *Karta*, is limited to the value of their individual interests in the joint property. The liability of *Karta* extends to all he owns as his separate and private property.

6. The extent or share of each member's interest in the family property including the business is always in a fluid state and fluctuating in character. The member's interest increases by death of any existing co-parcener and decreases by birth of a new co-parcener.

7. The Joint Hindu Family business is not dissolved by the death or insolvency of a co-parcener or the *Karta* himself.

8. The rights and liabilities of members of a family are regulated by the general rules of Hindu Law and customs. In contrast, the rights and liabilities of partners of a firm are determined by the provisions of the Partnership Act and by the Articles of Partnership.

9. The co-parceners cannot question the judgment of *Karta* in the conduct of the family business. If they are aggrieved, the only remedy of dissatisfied co-parceners is to demand a general partition of the family along with the division of all property thereof. Moreover, the co-parcener is not entitled, while severing his connection with the family business, to ask the *Karta* for an account of the past profits and losses. But in a partnership, the partners are always entitled to call for an account of past profits and losses at the time of their withdrawal.

10. On the death of a co-parcener, his undivided share in the family business devolves by survivorship upon the existing co-parceners. But in a partnership, the heirs of the deceased partner become the recipients of his interest in the firm, whether they are partners or not.

Evaluation of Partnership and Allied Forms. From the standpoint of business ownership, the general partnership, the limited partnership as well as the joint Hindu family business belong to the same group. The lines of business in which they are engaged are essentially the same with proprietary concerns. Actually, the characteristic patterns of a partnership business are manifested by its investment of small capital, application of personal skill and judgment, and the avoidance of risky ventures. The small manufacturing, trading and service concerns (except public utilities) are the peculiar spheres of its activities. Of late, the importance of this form is gradually declining in favour of the corporate form. The history of business houses is replete with cases of business conversions from partnerships to companies. Starting their careers as partnership concerns, many business enterprises have ultimately set themselves up in the form of companies.

THE COMPANY OR CORPORATION

The company has appeared last in the evolution of different forms of business ownership, but stands out as the best known form suited to the conditions of modern life. Being the latest in origin but the greatest in significance, the company has become today the dominant form of business throughout the whole world. The size of the business that is practicable under the partnership and other allied forms appears as pigmies in comparison with the giant business which can be established through companies. Not only it is meant for large-sized under-

taking, but it has equal applications in the sphere of small business as well. What is that virtue which has made the company a unique form of business ownership? It is the concept of legal entity that has created miracles in the business world.

The term 'entity' means something that has a real existence. Accordingly, legal entity implies that a company is attributed with a real existence of its own in the eye of the law. As a form of group ownership in business, the company in reality is nothing but the property that is owned jointly by a body of persons. The joint property in itself is an inanimate thing; a lifeless object of possession on the part of common owners. But this property has been personified in law, and the company is given a separate or distinct personality of its own apart from the owners thereof. We know that law can do this, since all types of ownership are created and protected by law. Because of the development of legal entity idea, a distinction has been made possible between the ownership of the company and the ownership of the company's property. That is to say, the company is owned by a body of persons who are called its shareholders or members; but the property of the company is owned by the company itself which is a legal individual, an artificial person or an invisible man.

The company has been formally defined as "An artificial being, invisible, intangible and existing only in the contemplation of the law. Being a mere creation of the law, it possesses only those properties which the charter of its creation confers upon it, among the most important of which are immortality and individuality".[1] To further our understanding, it can be said that a company is an incorporated, voluntary and autonomous association of many persons in business having joint capital divided into transferable shares of a fixed face value along with the features of limited liability, common seal and perpetual succession.

Features of the Company. The company form possesses the following features which have made it an unparalleled and unrivalled one among the forms of business:

I. *Legal entity*—A company requires incorporation for clothing it with the attribute of legal entity. Through the grant of legal entity, the company is given a separate and independent personality of its own, as distinguished from the individuality of owners who compose it. As the grant of legal entity is made by the State through its legal system, the joint owners are to observe the formalities prescribed in law for acquiring the separate personality on the part of the company. These legal formalities are referred to as the process of incorporation. By

[1] Chief Justice Marshall in the *Dartmouth College Case* (U.S.A.).

incorporation, a group of persons form themselves into a body corporate, the word 'corporate' being derived from the Latin root *corporare* which means "to shape into a body." It is evident, therefore the companies must be incorporated associations of owners, particularly in those cases where associations have membership exceeding ten in banking and twenty in other business. Nevertheless, the incorporation is not compulsory on the part of every ownership association in business. There are many ownership associations like partnership firms or joint Hindu family concerns which are not incorporated in fact. In other words, the company is a voluntary association of several co-owners in business.

In addition, the company is regarded as an autonomous association which means self-governing or self-controlling body. Evidently, the company being a separate person and having all the property in its own name, the owners of the company cannot be allowed to rob the company of its individual ownership rights. But the company can neither exercise the rights nor engage in business activities on its own physical or mental capacity, because it has no such capacity. For managing the affairs of this mute, dumb and innocent person, some elected representatives of the owners, known as directors, are placed in a position akin to trustees. As trustees for the company, directors need not be selected from among the owners of the company, and in many cases outsiders are taken in as directors. These directors form a committee or board which exercises almost all powers of the company as the cabinet of ministers does in a democratic State.

II. *Share capital and its divisions*—Individual contributions from owners of the company are lumped together in one block of capital which is known as share capital of the company, and it represents the aggregate ownership of the company's contributories. To facilitate contributions on the part of owners, share capital is divided into units of certain fixed amount. The divided units of share capital are referred to as shares and the fixed amount as face value or nominal value of each share. There are usually two types of shares—preference and ordinary. The holders of preference shares enjoy more or less a fixed rate of profit, but they are not allowed to cast votes in the election of directors. On the other hand, the holders of ordinary shares take such profits as the business of the company permits, and the election of directors is mostly done by them. Moreover the value of each preference share is generally much higher than the value of each ordinary share. According to the common practice followed in our country, preference shares are issued with a face value of Rs. 100 each, and ordinary shares with a face value of Rs. 20 or 10 each. However, all shares are transferable from one person to another unless the right to transfer shares is restricted under special circumstances. Besides, there are debentures which represent long-term loans taken by the company

from the investing public. For all practical purposes, debentures are like the preference shares of the company.

III. *Limited liability*—The liability of a shareholder is limited to the face value of the share he owns. The liability of a shareholder is extinguished on the payment of the prescribed face value of his shareholdings. As a rule, shareholders are never asked to contribute anything beyond the face value for meeting the debts and obligations of the company, since the debts of the company are not their personal debts.

IV. *Common seal*—The common seal is necessary for procuring the signature of the company. The name of the company is engraved on the common seal, and it is kept in the custody of directors. The common seal is affixed or embossed on all important documents and contracts that require the signature of this innocent creature. For purposes of evidence, of course, company's signatures are to be witnessed by the signatures of at least two directors.

V. *Perpetual succession*—The life of the company is not affected by the death, retirement or insolvency of shareholders as well as of directors. Groups after groups, new shareholders may come in and existing shareholders may go away, the company continues to exist in the same way. Even if all the shareholders suddenly die in an earthquake or in a plane crash, yet the company endures. The company can only be terminated or liquidated by the same legal process which gave it birth.

A fortunate combination of three outstanding features—limited liability, transferability of shares and continuous existence—has made the company an ideal form of business for amassing funds into a common pool. The company's widespread appeal for funds reaches all investors, far and near, rich and poor, pessimists and optimists, as well as individuals and institutions. Indeed, it would have been well-nigh impossible to secure the colossal amount of capital needed by hundreds of giant concerns through any other forms but the company.

Company and Partnership. The nature of the company can be further explained by drawing a contrast between the company and the partnership. Although both these businesses are owned by a group of persons, there are many points of distinction between them which may be stated as follows :

1. *Legal entity*—The company is an incorporated association with the attribute of legal entity, while the partnership is an unincorporated association with no such legal entity of its own. The partners are collectively called 'firm' for commercial convenience only and it has no special significance. As a result, a shareholder can make business transactions with his company which is a different person in relation

to him, but it is impossible on the part of a partner to enter into transactions with the firm of which he is a member. As the firm and its partners have the same entity or personality, no transactions are feasible between a firm and its partners.

2. *Nature of liability*—The liability of shareholders is strictly limited to the face value of share held by them and it cannot go further in any case. In contrast, partners of a firm assume unlimited as well as joint and several liability for debts and obligations of the partnership business.

3. *Transfer of share*—The share or interest of a partner in the partnership business is not transferable without the consent of all co-partners. The company shares are freely transferable at the option of shareholders, except in the case of a special class of companies known as private limited companies. And for this transfer of shares, shareholders are neither required to obtain the prior consent of other co-owners nor to inform the company by a subsequent notice.

4. *Dissolution and liquidation*—The partnership can be dissolved or liquidated in various ways, *e.g.*, by the death, retirement or insolvency of a partner, by the notice of dissolution from a partner in the case of partnership at will or by the completion of period or venture for which the partnership was formed. On the other hand, the company can be terminated or liquidated by the legal process only, *i.e.*, by the consent of the State which alone can create and terminate companies. A company does not come to an end even when all the owners thereof resolve for its dissolution.

5. *Number of owners*—The number of owners in a partnership varies from two in the minimum to a maximum of ten in banking business and twenty in other businesses. For a company the minimum number of owners has been fixed at two in private limited companies and seven in public limited companies, while the maximum can go up to fifty in the case of private limited companies and to a limitless number in the case of public limited companies.

6. *Managerial authority*—Ownership and management of the partnership business exist in unison, and all partners have the powers of management. For this purpose, partners are regarded as agents of the firm as well as of their co-partners. In contrast, the power of company management is concentrated in the hands of directors. The ordinary shareholders are deprived of the powers of management and they are never treated as agents of the company or its other members.

7. *State regulations*—The partnership is rather free from State regulations in its formation, operation or termination ; it is not called for to submit any reports and returns to the Government. On the other hand, the company being a creature of the State is subject to severe Government regulations. From the cradle to the grave, or from the

womb to the tomb, the company is to comply with the requirements of the law.

8. *Alteration of objects*—It is within the competence of partners to change object, capital, membership and other fundamentals of the firm by their mutual agreement. A company is not allowed to get its objects and other clauses of the Memorandum changed without the approval of the court or of the Government. Even the unanimous decision of all shareholders is of no avail for the purpose.

9. *Others*—These two forms of business ownership are controlled and regulated by two different enactments, *viz.*, the Indian Partnership Act, 1932 and the Companies Act, 1956. According to the provisions of these Acts, there are different accounting and audit procedures, and separate registration procedures with varying significances. Again, taxation bases differ widely between them.

Company and Joint-stock Company. The term 'joint-stock company' is used so extensively in the sense of company that one is forced to neglect the study of company evolution. Following the British discipline and tradition, many of us are accustomed to using the term joint-stock company in preference to company. The Britishers are well known for their innate conservatism and they do not like to change their habits of the bygone age. But wisdom dictates that we should copy their good things, not the conservatism in toto. In the U.S.A. and in the Continental countries, the joint-stock company means a separate form of business distinct from the company, or corporation as it is alternatively called. In studying the forms with their peculiar characteristics, we must know the exact nature of these two forms and the distinction between them.

The joint-stock company is a transitional form of business, halfway between the partnership and the company, possessing some features of both of them. Briefly, it is the present-day company minus its limited liability feature. In the sixteenth and seventeenth centuries when it was first organized in England for conducting foreign trade, the joint-stock company offered a distinct advantage over the partnership in regard to the business requiring larger capital and greater stability. In contrast to the partnership, the joint-stock company used to issue transferable shares to a large body of persons and the business was made exempt from dissolution for many of the common contingencies that used to cause the termination of the partnership. But in spite of these innovations, the joint-stock company of the old age could not avoid the burden of unlimited liability. Accordingly, it was not taken as a satisfactory form for conducting business operations, particularly those which were risky ventures; the search was continued for a better and improved form of business ownership. At long last, the present-

day company was evolved only in the nineteenth century with the development of legal-entity concept. Thanks to the growth of legal-entity idea, company formations went up by leaps and bounds, and separate legislation was passed in all countries for enabling the business enterprises to take the benefits of this new technical advance.

As distinguished from companies, the joint-stock company was not formed in our country before 1850 when the first Companies Act was passed. The principle of limited liability was first introduced in India in the year 1857. Hence, the companies that were formed between 1850 and 1857 were of the joint-stock company type. However, all such joint-stock companies got themselves reincorporated after 1857 with limited liability. Coming to foreign companies, the historical East India Company was a typical example of the joint-stock company. Of the present foreign companies, the Chartered Bank of India, Australia, and China was a joint-stock company in its early career.

It is gratifying to note, however, that framers of the Companies Act, 1956 have made an attempt to avoid the term joint-stock company for company purposes. As an evidence of this attempt, it may be pointed out that Registrar of Joint-stock Companies has been redesignated as the 'Registrar of Companies'. Furthermore, in the enumeration of associations which can seek registration under the company law, the joint-stock companies have been given the facility of registration as a company limited by shares or by guarantee.

ADVANTAGES AND DISADVANTAGES OF THE COMPANY

Advantages. 1. *Limited liability*—By making the liability of shareholders limited to the face value of their shares, the company has brought about an all-round improvement in the business world and has paved the way towards progress, prosperity and plenty for all. The limited liability stimulates industrial investments on the part of investors informing them as to the possible loss on their investments ; it permits the company to go in for risky ventures and to expand the scale of operations for securing the economies of large-scale production ; and both the consumers and the community are benefited by the creation and distribution of wealth in the form of numerous goods and services.

2. *Continuous existence*—An enduring existence of the business enterprise is a condition prerequisite for success. Investments in business must run through decades for bringing fruitful results in their wake. As a rule, the larger the period of investments, the better will be the rate of return on investments. For securing these beneficial results of long-term investments, the form of business is required to be both stable and durable in character. No other forms of business stand

comparison with the company so far as steady and continuous existence is concerned. The company can exist for generations together without any gap and disturbance.

3. *Transferability of shares*—It is the free transferability of shares which encourages savings of the community, promotes industrial investments and fosters economic growth of the country. The liquid character of shares furnishes the strongest appeal to investors for placing funds in companies. Through the purchase of company securities, the investors are assured of some return on their investments and of their realization in times of emergency.

4. *Capital accumulations*—The company as a form is well adapted for tapping the investing public very deeply and widely throughout the country, more accurately throughout the globe. Its extensive appeal for funds brings in countless individual contributions from different parts of the country. As it offers varied types of securities for catering to the needs of different investors, its appeal for funds becomes intensive in a particular centre. Moreover, it welcomes equally the buyer of one share or the buyer of one hundred shares. Both individual and institutional investors help in building a massive capital structure of the company.

5. *Unity of direction*—Since the power of management is vested in a board of directors, and since decisions are taken at board meetings by the majority rule of democracy, there exists a unity of direction in managing companies. Uniformity of procedures and continuity of policies are also maintained by the centralized authority of the board of directors.

6. *Effective management*—Because of the universal practice of authority delegation to management experts on the part of the board, the special ability, requisite skill and proper flexibility in management can be introduced to tone up the operating efficiency of the company. For the successful working of different companies, the management skill has been developed to a degree of professional expertness.

7. *Possibility of growth*—The company form is conducive to the continuous expansion of business operations and has opened the way for giant enterprises with wide ramifications. The two limiting factors of expansion—limited ability and limited capital—can be easily overcome in the case of companies. As a result, the company enjoys the greater potentiality of growth.

8. *Public confidence*—The company form is subject to Government censure and regulations to a marked degree. Since the affairs of the company are made known to the public without any reservation, the prestige and market standing of the company go up proportionately. As the guardian of the community, the Government exercises a healthy control over the formation and operation of all corporate enterprises.

9. *Social contributions*—The company operates to the benefit of all concerned. It permits many small investors to participate in business profits ; it offers employment to many persons, whether they are skilled or unskilled ; and the company supplies the greatest volume of goods and services to consumers and the largest amount of revenues to the Government among the forms of business.

10. *Tax advantage*—To the owners of the business, the company provides an added facility. The company, as an artificial person, is a separate taxable entity which still enjoys in respect of higher incomes an advantage of a reduced incometax burden over other natural persons like proprietors and partners.

Disadvantages. 1. *Formation difficulty*—The company formation involves an expensive, time-consuming and cumbersome process. Several documents and statements are to be drafted, printed and executed for the purpose of registration ; in addition, a substantial amount is to be paid by way of registration fees, filing fees and stamp duty.

2. *Crushing regulations*—The company comes under Government regulations from its start to finish. Many and varied legal formalities and restrictions appear as so many impediments to the normal operation of a company. To comply with these regulations, a large secretarial staff has to be maintained, and the energy of the company is diverted from business to non-business activities.

3. *Despotic control*—The so-called democratic control of company's affairs is not corroborated by facts. The owners of the company in many cases are divested of the power of control, and an inner ring of shareholders or an entrenched management team elbows out the owners from having any real voice in the company. That the directors are said to be the elected representatives of shareholders appears on a close analysis as a great hoax or a stupendous myth.

4. *Impersonal management*—Deriving their authority from the shareholders, the directors delegate their powers of management to a chief executive who in turn delegates such powers to the salaried managers. These salaried management personnel may not be motivated to act for the best interest of the company. Furthermore, greater powers of control without any corresponding financial stake may create conditions which are productive of various frauds and manipulations in affairs and of speculations in shares. Because of these situations, the company may be brought to an ultimate ruin and liquidation.

5. *Neglect of minority*—The company is perpetually ruled by the majority group of shareholders with controlling voting rights. Shareholders who own the minority voting interests are never represented on the board of directors, and not even one seat out of several directors is given to the minority. As a consequence, the minority group may

be oppressed and aggrieved by the activities of the majority group of shareholders.

6. *Promotional frauds*—Risks of floating unsound companies and of liquidating sound companies by unscrupulous company promoters are inherently bound up with the company business. As shareholders are widely separated from one another and remain mostly unknown to either directors or other members, the company form may appear as a device for deceiving the unwary investors. The ignorant investors are made to suffer a colossal sum through the artful tricks of fraudulent promoters.

THE CO-OPERATIVE ASSOCIATION

In sharp contrast to other forms of business ownership which are run with the profit motive, the co-operative associations are established for rendering services to their members. The weaker sections of the community, as a measure of self-defence, take resort to this form for making themselves free from exploitations under the modern methods of production and distribution. That is to say, the formation of co-operatives is designed to secure the full benefits of business undertakings through an equitable division of the business income among the members. Members participate in the business in different capacities like producers, consumers, workers and managers. As a result, the total sale proceeds of goods and services dealt in by the co-operatives come back to the members in some form or another.

Features. Being different in their outlook, the co-operative associations possess certain features which may be stated as follows :

1. Capital is jointly supplied by the members. Each member of the co-operative has usually one vote, irrespective of the amount he may contribute towards its capital. A co-operative may be organized on the basis of either limited liability or unlimited liability. The unlimited liability is the rule in the case of credit societies in rural areas where the majority of members are farmers. In the case of limited liability societies, the word 'limited' must be used as a part of their names.

2. The business of the co-operative is conducted by the members themselves unless it grows to an unmanageable size. Members of the co-operative gather at the annual general meeting, formulate the broad policies for the conduct of business, and elect the office bearers or the managing committee by the casting of their votes. The managing committee is supposed to execute policies enunciated by members. Thus, the ownership and control of this form of business are perfectly harmonized. The co-operative stands for the democratic control of its affairs and creates a common interest among its members.

3. Membership of a co-operative is always thrown open to all local persons who may like to come in. Unlike the practice of a company, the subscription list of the co-operative is not closed after a fixed period. In matters of subscription, however, a maximum limit is placed on contributions that can be made by an individual member. Usually, a member cannot own more than 10% of the total share capital of the co-operative, it can be even less if the bye-laws so provide. For example, under the Indian Co-operative Societies Act, 1912, a member cannot subscribe for shares of more than rupees one thousand in value. Shares are not transferable to other persons, although they are automatically transmitted to heirs on the death of a member. Being deprived of their marketability, shares can revert back to the co-operative society.

4. Profits of the business are not distributed by way of dividends among the members. At least one-fourth of the profit must be transferred to the general reserve and a certain percentage, not exceeding ten, may be utilized for general welfare of the locality. A part of the profit is also used for giving rebate to members on their amount of purchases from the co-operative and for allowing some interests on the members' capital investments in some cases.

5. The co-operative association may get itself registered with the Registrar of Co-operative Societies. The Registrars are appointed by State Governments for registering societies and supervising them. The registration can be done in accordance with the provisions of the Indian Co-operative Societies Act, 1912, or the relevant State Co-operative Societies Act where such an Act is in force. The requirements of registration are (*a*) that there must be at least 10 persons above the age of 18 years (majority in age), (*b*) that members must reside in the same town or village, or they must belong to the same tribe, occupation or like brotherhood, (*c*) that all particulars as to membership, objects, share capital, etc., are furnished to the Registrar through a joint application of the members, and (*d*) that a copy of the bye-laws containing rules, regulations and other details of the society is submitted to the Registrar for scrutiny.

6. On registration, the co-operative becomes a body corporate like the company and acquires the facilities of perpetual succession, common seal and legal entity. Registered co-operatives enjoy certain privileges from the side of the State. They are usually exempt from the payment of income tax, stamp duty and registration fees. In return for these privileges, the State controls and supervises the operation of co-operatives to some extent. Furthermore, the shares of a co-operative society are not liable to attachment by outside creditors. On the contrary, the co-operative society as a creditor has the priority to enforce its claim over other creditors.

Co-operative and Company. It is apparent from the features of a co-operative association that it differs from the company form in several respects. A contrast between the co-operative and the company may be drawn in the following manner :

1. *Aims and objects*—The co-operative aims at the material and moral well-being of its members. Generally, it is organized by the financially weaker sections of the community for betterment of their economic life. The primary motive of all co-operative enterprises is to render some services to their members. Companies are organized, on the other hand, for exploiting any business opportunity with the primary motive of profit making. The prospects of profit are the driving force that induces promoters and investors in setting up a company. The moral welfare is never contemplated by company shareholders who are associated with the business.

2. *Ownership and management*—The co-operative is owned and managed democratically by the persons of a local community. As a result, a close and friendly relationship exists between members of a co-operative. In contrast, the company is owned by persons of different localities, and the members remain mostly unknown to one another. Moreover, management is not correlated with the ownership of the company, and a wide separation between ownership and management is to be found in many cases. Although company management is professed to be a democratic one, it is far removed from such an ideal in actual practice.

3. *Share capital*—A company organized for a business must have some share capital divided into shares that are transferable. A co-operative enterprise may or may not have any share capital, and even when it possesses share capital, shares are not made transferable on the part of owners. Actually speaking, men control capital in a co-operative association, while capital controls men in the company form of business association.

4. *Registration*—As a legal person, the company requires registration in all cases. The legal process controls the company from its cradle to the grave. As opposed to this situation, registration is optional in the case of co-operative enterprises. Furthermore, all business companies are limited liability concerns, but co-operatives need not be limited liability concerns even when they are registered. The registration is effected by the Registrar of Co-operative Societies under the Co-operative Societies Act in one case, while registration is effected by the Registrar of Companies under a different Act in the case of companies.

5. *Number of members*—For registering a co-operative society, at least ten persons are necessary, and there is no limitation on the maximum number of its members. But the minimum number is two

in the case of a private limited company and seven in the case of a public limited company. The maximum number of members is limited to fifty in private limited companies.

6. *Exemption and privileges*—On their incomes, the co-operatives are not required to pay income taxes, and for the registration of such societies, registration fees and stamp duty are not necessary. Obviously, a company is never exempt from these taxes and levies. Because of the Government subsidy and help, accounts of registered co-operative societies are inspected and audited by the Registrar of Co-operative Societies.

Classes of Co-operatives. The co-operative is considered to be the cure for many economic ills, and as such co-operative associations have been formed in different areas of our economic life. From the nature of their activities, the co-operatives may be broadly classified into the following categories :

a. Industrial co-operatives—Industrial co-operatives are usually referred to as producers' co-operatives. They are organized by small producers for securing some of the benefits of large-scale production and for increasing their competitive strength against the large producers.

b. Marketing co-operatives—They are established for the selling of manufactured products or agricultural commodities. Accordingly, marketing co-operatives are subdivided into consumers' co-operatives and agricultural co-operatives. (*i*) Consumers' co-operatives, or retail co-operatives as they are alternatively called, aim at supplying the products at cheaper prices to their members through the elimination of middle-men. Products are secured in bulk direct from the manufacturers at a concessional rate for distribution among the members. Because of the elimination of trading profits, on the one hand, and of the procurement of goods from manufacturers at a quantity discount, on the other, members of the consumers' co-operatives are assured of getting the needed products at a rock-bottom price. (*ii*) Agricultural co-operatives are organized by farmers for marketing their own farm products as well as for obtaining their requisites for agricultural operations and their everyday needs of life. Thus, agricultural co-operatives are engaged in a two-way traffic for selling farm products and buying seeds, manures, implements and many other consumers' goods. As agricultural marketing involves several steps like processing, warehousing, financing, etc., these co-operatives are often formed on a multi-purpose basis for catering to the needs of agriculturists both as sellers and buyers of products.

c. Credit co-operatives—These are formed by members to pool their savings and to invest the resources thus collected in giving loans

to members on easy terms of interest, security and repayment. Credit co-operatives are organized both in rural and urban areas. Credit co-operatives in rural areas are called primary societies or rural credit societies, while their counterparts in urban areas are known as co-operative banks.

d. Service co-operatives—These co-operatives are organized for rendering different types of services to their members at a nominal charge. Important co-operatives in the field of services are insurance societies, housing societies, transport societies and storage societies. Housing societies provide their members with means of owning residential houses. In the sphere of insurance, the mutual societies are worth mentioning ; the policy holders are the members of such concerns, and the business of insurance is run to their entire benefits.

Merits and Drawbacks of Co-operatives. Different types of co-operatives have distinct merits to their credit. But there are some common merits which can be witnessed everywhere. (1) The co-operatives are organized for rendering services which constitute their keynote. Consumers' co-operatives provide their members with quality goods at fair prices. Industrial co-operatives help the small producers in procuring raw materials, in fabricating materials into finished goods, as well as in marketing their products to ultimate consumers. (2) Voluntary service rendered by members reduces the operating expense to a great extent, and the managerial cost is practically nil in many cases. (3) Since the demand for, and the supply of goods can be co-ordinated in a better way, any excess production or acquisition of goods and the accumulation of unnecessary stocks are avoided by co-operatives. (4) Advertising and other selling expenses find no place in a co-operative enterprise. As a result of reduced marketing expenses, goods can be offered at cheaper prices. (5) The co-operative is a desirable form of business from the social point of view. It fosters fellow-feeling among members of an association and imparts those moral and educative values to their everyday life which are essential for better living. Furthermore, the benefits and profits of a co-operative are enjoyed by those people who deserve such gains for the reduction of glaring disparity in the national income.

As against these merits, there are some drawbacks of co-operative associations which prevent them from securing the full extent of such benefits. (1) Because of the lack of business experience and managerial ability of members, the business of a co-operative is not conducted efficiently. For improving the management competency, co-operatives cannot employ outside talents and trained personnel, since such steps are incompatible with their avowed ends and limited means. (2) A co-operative can only succeed when the members are imbued with a

spirit of co-operation. Unfortunately, such a spirit of co-operation and service becomes conspicuous by its absence in many co-operatives. Through the subordination of common interest to their individual interests, members are found to make the co-operative a source of their personal gains. (3) Sustained efforts over a period are the pre-requisite factor of success in any business. But such a state of affairs does not exist in many cases. Within a short period of its dramatic start, the co-operative becomes lifeless and inactive in its nature. (4) It cannot be denied that internal dissensions and rivalries among members sap much of its strength and vigour. The absence of co-ordinated and joint actions is responsible for the collapse of many co-operative associations.

DEVELOPMENT OF CO-OPERATIVES IN INDIA

The principles of co-operation were introduced in India at the dawn of the present century by the Co-operative Societies Act, 1904. But this Act of 1904 recognized credit societies alone, and to overcome that limitation, the scope of the Act was extended by a subsequent statute in the year 1912. The Act of 1912 remains operative in the country up to the present time. Besides the enlargement of the scope for co-operation, the Act of 1912 laid down a structure of co-operative organization with a tapering authority relationship among its three component parts. Primary societies which deal with farmers in villages have been placed at the bottom of the structure. Above the primary societies there exist a number of central co-operative banks for supplying funds to primary societies and for guiding, supervising or controlling their activities. The State co-operative bank has been superimposed over the structure as an apex body. The State co-operative bank collects resources from the Reserve Bank for their lending to primary societies through the medium of central co-operative banks. This model for credit co-operatives has provided the set pattern to be adopted in the case of other societies. In the sphere of credit co-operatives, there are many land mortgage banks which supply long-term credit facilities to agriculturists from the funds made available to them by the Reserve Bank of India.

The co-operative associations did not progress much in the country over a period of fifty years and were confined mostly to credit societies. That co-operatives could not make any headway during this period was pointed out by the All-India Rural Credit Survey Committee in its report in the year 1954. The Committee observed that in the field of rural credit, co-operation failed, and it covered only 3% of the loans availed of. But it must succeed for eradicating poverty, unemployment and economic distress in the country. For the realization of these

ends, the Committee made its succinct recommendation for "an integrated scheme of rural credit" by way of dovetailing other activities with credit facilities. In the words of Mr. A D. Gorwala, the chairman of this Committee, co-operation can be made to succeed by combinations of better and stronger societies not only for credit but for marketing and processing as well, with the provision of properly managed warehouses run by a competent authority.

New Measures for Development. Since the advent of five-year plans, a vigorous and purposeful attempt is being made by the Government to reorganize the co-operative societies and to revitalize their functioning in the country. That the Government is serious on their growing importance in the national economy is evident from the following radical measures taken by it.

1. The old Imperial Bank of India was nationalized on July 1, 1955, and the State Bank of India emerged in its place with the special object of extending increased credit and remittance facilities to all co-operative societies in the country. The statutory obligations for opening 400 additional branches throughout the country were fulfilled in time and branch expansion was steadily continued thereafter. At the end of June, 1973, the State Bank of India had 2,867 offices and its subsidiaries had 1563 offices in India. 14 nationalised banks with their 8,109 offices also extended a sizeable amount of credit to the co-operatives.

2. For enabling the State Governments to participate in the share capital of all co-operative institutions, two separate Funds were created by the Reserve Bank of India during the first half of 1956. Since their setting up in 1956, an annual sum of not less than Rs. 5 crores is being placed to the credit of the National Agricultural Credit (Long-term Operations) Fund in addition to an initial contribution of Rs. 10 crores. The amount to the credit of the Fund stood at Rs. 239 crores on June 30, 1973. To the other Fund which is known as the National Agricultural Credit (Stabilization) Fund, a recurring annual contribution of Rs. 1 crore is being made by the Reserve Bank. The amount to the credit of the Fund stood at Rs. 85 crores on June 30, 1973. The object of the first Fund is to grant long-term loans to the State Governments and to the Central Land Development Banks for enabling them to subscribe for shares and debentures of co-operatives or to make direct lending. The Stabilization Fund is meant for giving financial assistance to the State Co-operative Banks for enabling them to convert their short-term loans into medium-term credits in cases of famine, drought or similar other calamities. In addition, the Agricultural Refinance Corporation has been established in July 1963 with an authorised capital of Rs. 25 crores for the provision of medium and

long-term credit by way of refinance or otherwise to eligible institutions. Since its inception, the Corporation sanctioned refinance for 923 schemes involving a total commitment of Rs. 523.1 crores up to June 30, 1973. For financing agriculture, the Agricultural Finance Corporation was established in 1968. Since its inception, the Corporation sanctioned 51 schemes involving a total outlay of Rs. 173.0 crores up to the end of June 1973.

3. For promoting and co-ordinating credit facilities with other agricultural activities like marketing, processing and warehousing, the National Co-operative Development Corporation has been established in March 1963 under the Agricultural Produce (Development and Warehousing) Corporations Act, 1956. A large number of warehouses have been built by both the Central and State Warehousing Corporations. The Central Warehousing Corporation from its inception in March 1957 has already established 144 warehouses with a storage capacity of 1.56 million tonnes up to March 1973. All the State Warehousing Corporations have set up 777 warehouses with a storage capacity of 1.59 million tonnes up to March 1973.

4. At the end of June 1973, 1383 co-operative banks comprising 28 State co-operative banks, 367 central co-operative banks and 988 primary co-operative banks were brought under the purview of the Banking Regulation Act, 1949. Moreover, 404 co-operative banks were registered by the Deposit Insurance Corporation. With a view to reorganizing the co-operative sector, a scheme was initiated for reducing the number of primary agricultural credit societies. The number of such societies was expected to come down to 1.50 lakhs in June 1974.

5. Other important measures include (*a*) training of higher, intermediate and subordinate personnel required for the operations of different co-operatives, (*b*) establishment of more than ten thousand large-sized societies on the basis of limited liability, (*c*) grant of short-term accommodation by the Reserve Bank to all apex co-operatives at 2 per cent below the Bank Rate, (*d*) subsidies towards meeting the managerial cost of new co-operatives for the first three years, (*e*) extension of benefits of deposit insurance to all co-operative banks, (*f*) routing Takavi loans through co-operatives, and (*g*) strengthening of the staff of the co-operative departments of State Government for introducing effective supervision and audit.

For the development of co-operatives, a multi-prong approach has been adopted in Five Year Plans. Under the Plans, the number of membership of primary agricultural credit societies is proposed to be steadily raised so as to cover the entire population. Likewise, the number of agricultural marketing co-operatives is proposed to be raised so as to cover all *mandis* in the country with a programme for construct-

ing godowns at *mandi* centres. Besides, there are programmes for the setting up of co-operative sugar factories, processing units and a number of other co-operatives in many spheres of economic life.

Despite this development programme, the co-operatives may not make all-round progress in different areas of their operations. There are certain inherent limitations which arrest the growth of co-operatives to a satisfactory level. For example, agricultural activities are more suitable for co-operative enterprise rather than manufacturing activities. Furthermore, the rural co-operative possesses a greater vitality and stamina for existence as compared to urban co-operatives. For the rapid development of cottage and village industries, a great reliance has been placed upon the industrial co-operatives. But it is doubtful whether they will be able to make the same amount of progress as can be done by the agricultural co-operatives. (Industrial co-operatives have been discussed in Chapter 36 of the book).

CONSIDERATIONS IN THE CHOICE OF FORMS

The existence of different forms of business along with their varying characteristics calls for a choice among alternatives. Where capital requirements are very large, the company form comes out as an obvious choice. On the other hand, the very small business is usually best conducted as a proprietary concern, since it has little to gain from other forms requiring an association of several owners. Between these two extremes, the choice of a form has an important say over the ultimate success of the business. Besides the scope for raising capital, there are many other factors which exert varying degrees of influence on the choice of a form. The different considerations may be stated under the following eight points :

1. *Facility of formation*—The comparative facility or difficulty under which a business can be formed makes one form more attractive than another. The question of suitable business associates, formation expenses and legal restrictions are to be considered in choosing a form of business. Unless the extra expense and trouble required for undertaking a complicated form are justified by its corresponding advantages, the most simple form appears desirable.

2 *Scope for financing*—With the increasing importance of capital in present-day business, the capacity of capital accumulation has become a major consideration. The capacity of raising capital varies from one form to another. Generally speaking, the important determinants of capital investments from the side of investors are safety of investments, return on investments, future liability on investments, as well as the transferability of investments.

3. *Nature of liability*—The business is beset with many risks and

uncertainties. Evidently, the form of business which can reduce this risk to a minimum is to be preferred from others. However, a certain amount of risk is necessary for supplying the driving force in business. The absence of this spur in any business may lead to weakness, inefficiency and even dishonesty, on the part of management personnel. Any greater liability than what is required for this purpose is undesirable from the social as well as the individual point of view.

4. *Effectiveness of management*—Management is the most crucial factor of success in any business. It is the competency of management members which can pull up a falling business to a dizzy height, or which can pave the way towards hell for a sound concern. This vital and pivotal management capacity is determined by three factors—motivation, skill and flexibility. The motive for efficient management is highest in those cases where ownership and management go hand in hand. Because of the directness of reward to business efforts, the intensity of desire is of extreme character when the rights of ownership and management fully coincide. Besides motivation, skill and flexibility in management can be introduced by taking outside talents, whether in the capacity of co-owner or salaried staff. The greater the scope for recruiting outside talents, the better will be the flexibility and skill of management.

5. *Endurance and stability*—The stability of a form is desired by three interested parties in all business concerns, *viz.*, the owners, the employees and the consumers. The form that is likely to survive through decades or generations by the avoidance of all disturbing and disrupting factors is destined to have a successful career in business.

6. *Legal status*—The different forms of business are rather different kinds of business ownership. As the ownership rights and facilities are in a state of constant flux because of the ever-changing legal rules, the legal status or the bundle of ownership rights may be a determinant factor in many cases.

7. *Extent of Government regulations*—From the business point of view, the form which is free from Government regulations in its day-to-day working is to be chosen. For keeping the business within the bounds of law, much energy may be diverted from business to non-business activities. Although Government regulations are mostly based on the size of business enterprise rather than on the form of business, yet corporate forms are usually placed under greater control because of the facility of their rounding up by the State.

8. *Taxation*—The tax burden varies considerably between a corporate form and a non-corporate form under the Income Tax Act. Companies are legal persons, and as such they are taxed as distinct bodies on their income in addition to tax paid by shareholders at the time of dividend distribution. Whatever be the size of income, com-

panies pay a uniform rate of tax. On the other hand, proprietorships or partnerships have no tax entity apart from the owners thereof. The owners of such business are taxed as individuals on the total income of their businesses, whether such incomes are actually distributed or retained in the concern. Individual incomes are taxable on a slab system with varying rates for different slabs ; in addition, there are questions of taxable minimum and lower rates of tax in the case of smaller amounts of income. Because of these divergent questions, there can be varying tax burdens for different sizes of income on the part of corporate forms and non-corporate forms. Generally speaking, corporate forms are advantageous for larger amounts of income. For smaller amounts of income, non-corporate forms enjoy a tax facility.

Conclusion. Of all these considerations, the facility of raising capital is regarded as major consideration in the setting up of all large-sized enterprises, and taxation becomes the major consideration to the small enterprise. Other considerations are of lesser significance. In the context of capital requirements, the size of income and the availability of management skill, the choice of a form is to be made from balancing the advantages arising from other considerations.

CHAPTER 4

PROMOTION AND FORMATION OF COMPANIES

MEANING AND NATURE OF PROMOTION

Promotion may be defined as the development of a business idea, and the subsequent organization of the factors of production with a view to making profits therefrom. It is a truism to say that no enterprise can come into existence without the pioneering work of a promoter. Someone must take the trouble and initiative in visualizing a business enterprise and in setting it up as a going concern. It is the promoter who conceives the idea, studies the prospects of a business critically, chalks out a tentative scheme of organization, brings together the requisite men, materials, machines, money and managerial ability, and starts off the venture.

The promoter hunts after business possibilities. He is always on the look-out for new inventions, new methods of production and new developments of transport that may offer him a new business opportunity. He also studies the trends of demand so as to find a new business through the adjustment of existing enterprises. Being detached from the details, the promoter is able to take a broader view of the business yet to come into being. When an idea takes root in his mind, he starts working to convert that idea into a profitable reality. For the purpose of getting the financial support of the investing public, he attempts to make many persons interested in his project. In this way dormant funds of the community come into play with business possibilities under the care and control of the promoter.

Establishment of a small business either on a proprietary basis or on a partnership basis does not require any such extraordinary activities on the part of promoters. Accordingly, the organizers of a partnership or a proprietary business are not regarded as promoters. It is in the formation of larger companies that the role of the promoter becomes significant and appropriate. The promoter must be able to convince others about the soundness of his business.

To sum up the role of promoter in the words of Mead, "The promoter performs an indispensable function in the community by discovering, formulating, and assembling the business propositions by whose development the wealth of the society is increased. He acts as the middleman or intermediary between the man with money to invest in securities and the man with undeveloped property to sell for money. The unassisted coincidence of investment funds with investment

opportunities is fortuitous and uncertain. Left to themselves, they might never meet; it is the promoter who brings these antithetical elements together."[1]

Steps in Promotion. The work of promotion may be divided under four heads, namely, discovery, investigation, assembling and financing.

Discovery—The mere finding of a business opportunity or hitting upon a chance is not what is meant by the term 'discovery'. It is the development of a practicable or feasible idea that finds favour in the business world. It involves a preliminary analysis and inspection of the proposed idea to find out whether the business would be profitable or not. The risks involved in the proposition and the probable amount of capital requirements are taken into consideration by the promoter. After all these enquiries, he decides to bring his ideas into the realm of a practical possibility.

Investigation—The promoter makes an intensive research at this stage. Soundness of the proposition is thoroughly investigated by him so as to reveal the probable cost of production, the estimated selling price of the goods or service, and the amount of profit which could be earned from the project. He studies the market and the demand for the products very critically to see whether they can upset his calculations in the near future. Investigation is concluded by the findings as to whether it would be worthwhile to go ahead with the proposition.

Assembling—It consists of a detailed plan of organization. He arranges for the acquisition of necessary men, materials, money and managerial ability. However, factors of production are not physically assembled at this stage, but he simply makes contracts to ensure their availability. In the drawing out of a plan, the promoter is required to estimate the total capital requirements comprising initial fixed capital, working capital and development capital very carefully. A well-conceived business enterprise often fails by its bad financial planning. In the meantime, the promoter gets the company registered and purchases some items of the asset out of his own funds to enable the company to make an early start.

Financing—To put the company on a sound financial footing, adequate resources must be collected through public participation. The promoter directs his appeal for funds through the issue of a prospectus and other methods. In consultation with underwriters and financial institutions, capital gearing, *i.e.* proportion of different securities to total capital, is fixed. The work of promotion comes to an end with the actual marketing of securities.

[1] Mead, Edward Sherwood, *Corporation Finance* (1933).

INCORPORATION OF COMPANY

A company may be incorporated in three different ways :

By Royal Charter—This was the earliest method of incorporation available to the old joint-stock company bereft of the concepts of legal entity and limited liability. The East India Company was a chartered company. Another chartered company which is even now operating in our country is the 'Chartered Bank of India, Australia and China'. At present, this method of incorporation has become obsolete.

By Special Act of Parliament—This method of incorporation is employed only for companies of national importance, *e.g.* the Reserve Bank of India, the State Bank of India, the Industrial Finance Corporation, the Indian Airlines Corporation, the Damodar Valley Corporation and others. These are popularly known as statutory companies or public corporations.

By Registration under the Companies Act—This is the usual method available for incorporating a business company. The Companies Act provides for the registration of three types of companies, namely (*a*) companies limited by shares, (*b*) companies limited by guarantee and (*c*) companies unlimited.

Limited Liability Companies. The liability of a company may be limited either by share or by guarantee. Both of them are to be called limited liability companies. "A company having the liability of its members limited to the amount, if any, unpaid on the shares respectively held by them" is known as a *company limited by shares*. A *guarantee company* means, however, "a company having the liability of its members limited by the Memorandum to such amount as the members may respectively undertake by the Memorandum to contribute to the assets of the company in the event of its being wound up."

Both of these limited liability companies may again be subdivided into public and private. A private limited company means a company which, by its Articles (*i*) restricts the right to transfer its shares, (*ii*) limits the number of its members to 50, and (*iii*) prohibits any invitation to the public to subscribe for any shares in the company or debentures of the company. According to the Companies Act, 1956, all private limited companies must use the words "Private Limited" as the last part of their names. Public limited companies must use the term "Limited" as the last word in their names. (Further discussion about private limited companies will be made towards the end of the following Chapter.)

Companies limited by shares are the only form, in actual practice, which can be adopted by a business enterprise. Companies limited by guarantee cannot be used for business purposes. Hence, the

division of a guarantee company into public and private becomes immaterial in the context of objects for which this company is formed. Companies limited by guarantee are organized for promoting commerce, art, science, religion, charity or any other useful object. These companies intend to apply their entire profits for the accomplishment of companies' objects and restrict the distribution of profits among the members. In exchange for utilizing the profits in the aforesaid manner, they enjoy the privilege of stating their names without the use of the restrictive term 'Limited' or 'Private Limited', as the case may be. Different Chambers of Commerce, Universities and Sporting Clubs have been established as guarantee companies.

Unlimited Liability Companies. This type of company is not reported to be working in the country, and the absurdity of registering an unlimited liability company is apparent. Before the evolution of modern company, or corporation as it is called in America, joint-stock companies were unlimited liability companies. But with the introduction of limited liability concept, all such joint-stock companies got themselves reincorporated with limited liability.

Government Company. The Companies Act provides for another class of company in the public sector as opposed to the different types of companies in the private sector. The Government company means any company in which not less than 51% of the share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments. In other words, the company limited by shares in which the Government has a dominating interest is known as a Government company and it may be either a private limited or a public limited company.

A Practical Classification. Instead of classifying companies from the standpoint of the Companies Act, we may classify them according to the nature of their activities for clarity of our understanding.

Government Company—A large number of Government-owned companies have been established recently in our country for the conduct of State business enterprises, such as the Hindustan Steel Limited, the Hindustan Machine Tools Limited, the Hindustan Shipyard Limited, the Sindri Fertilizers and Chemicals Limited, and many others.

Non-stock Companies (Charitable companies)—These companies are formed without any profit motive by the religious, educational and charitable institutions.

Business Companies—These companies are organized with a share capital for making profits from business activities. These business com-

panies can be subdivided into (1) financial companies, (2) industrial companies and (3) public-utility service companies. From the standpoint of companies' nationality, the business company may again be (*i*) a domestic company or (*ii*) a foreign company.

REGISTRATION OF COMPANY

Companies are incorporated by effecting registration with the Registrar of Companies in the State concerned. A minimum of seven persons for a public limited company and two persons for a private limited company are required to submit the following documents and statements for the purpose of such registration :

1. The Memorandum of Association.
2. The Articles of Association, if any.
3. The statutory declaration by an advocate or others that the requirements of registration have been complied with.

A public company limited by shares has to submit the following two additional statements :

4. The written consent of the Directors to act as such.
5. The agreement of Directors to take qualification shares when they do not sign the Memorandum for a sufficient number of shares.

Besides the above documents, a notice of the address of the registered office may be filed with these documents ; otherwise this must be done within thirty days from the date of registration. The Companies (Amendment) Act, 1960 permits the directors to file their written consent to act as such within thirty days of their appointment.

The necessary filing fee of Rs. 5 or more per document, requisite stamp duty on Memorandum and Articles, and the required registration fees must be paid so as to get the company registered. The registration fee is fixed on a graduated scale based either on the amount of nominal capital or on the number of members.

The table of fees has been altered twice by notifications on 21st December, 1956 and 31st January, 1961 after the enforcement of the Companies Act, 1956. According to the new table, the following registration and filing fees are payable on the part of a company limited by shares :

A. Registration fees—

On the first 20,000 rupees of share capital or part thereof ..	Rs. 100.00
On the next 30,000 rupees of share capital, for every Rs. 10,000 or part thereof	Rs. 50.00
On the next 4,50,000 rupees of share capital, for every Rs. 10,000 or part thereof	Rs. 25.00

On the next 5,00,000 rupees of share capital, for every Rs. 10,000 or part thereof	Rs.	15.00
On the next 15,00,000 rupees of share capital, for every Rs. 10,000 or part thereof	Rs.	10.00
On the balance rupees of share capital, for every Rs. 10,000 or part thereof	Rs.	7.50

B. Filing fees for each document—

Where the share capital is less than Rs. 1,00,000	Rs.	5.00
Where the share capital is Rs. 1,00,000 or more but less than Rs. 5,00,000	Rs.	12.50
Where the share capital is Rs. 5,00,000 or more but less than Rs. 25,00,000	Rs.	20.00
Where the share capital is Rs. 25,00,000 or more	Rs.	25.00

Besides the above fees, the stamp duty is payable to the State Government and it varies from one State to another.

In West Bengal, the present stamp duty is as follows:

C. Stamp duty on Memorandum & Articles—

Where the capital does not exceed Rs. 1,00,000	Rs.	100.00
Where the capital exceeds Rs. 1,00,000	Rs.	160.00

The Registrar of Companies, on receipt of the documents and fees, issues *a Certificate of Incorporation* which evidences conclusively that the company has come into being as a distinct body. A private limited company can forthwith commence business after the receipt of the Incorporation Certificate. But public limited companies cannot commence business or exercise any borrowing power without obtaining from the Registrar a second certificate known as the *Certificate for Commencement of Business.*

MEMORANDUM OF ASSOCIATION

The Memorandum sets down the constitution of a company containing certain fundamental matters. It is a basic document for the very existence of the company. The Memorandum builds the framework of the company edifice within and inside of which a company must function. The Memorandum is the charter of the company containing its birth story, so to say. It defines and limits the powers of a company for the information of the public at large. The purpose of the Memorandum is to display the permitted range of activities of a company for the guidance of shareholders, creditors and others.

Forms and Contents. The Memorandum of a company is required to be drawn up in appropriate forms provided in Tables B, C, D and E of Schedule I to the Act. The Memorandum in Table B is meant for a company limited by shares and is reproduced here for the guidance of readers, since the Memorandum is supposed to be drawn up in the

prescribed form or in a form as near to that as circumstances would permit.

COMPANY LIMITED BY SHARES
Memorandum of Association
of
The Eastern Steam Packet Co., Ltd.

First—The name of the company is, "The Eastern Steam Packet Company, Limited."

Second—The registered office of the company will be situated in the State of West Bengal.

Third—The objects for which the company is established are the conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine, and the doing of all such other things as are incidental or conducive to the attainment of the above objects.

Fourth—The liability of the members is limited.

Fifth—The share capital of the company is two hundred thousand rupees, divided into one thousand shares of two hundred rupees each.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names:

Names, addresses, descriptions and occupations of subscribers		Number of shares taken by each subscriber
(1) A. B. of————————	Merchant	200
(2) C. D. of————————	"	25
(3) E. F. of————————	"	30
(4) G. H. of————————	"	40
(5) I. J. of————————	"	15
(6) K. L. of————————	"	5
(7) M. N. of————————	"	10
	Total shares taken ..	325

Dated, the————————1 day of————19 .

Witness to the above signatures
X. Y. of————

Explanatory Notes

I. *Name Clause*: (*a*) The name of the company must be stated with the last word 'Limited' in the case of public limited companies and with the last two words 'Private Limited' in case of private limited companies.

(*b*) The Companies Act provides that a company should not be registered with an undesirable name. The question of desirability or otherwise of a name can only be decided from

the facts and circumstances of each case. Generally, any name implying or signifying the royal or government consent and sanction is deemed undesirable. The Act provides specifically that a name which is identical with or too nearly resembles the name of an existing company is undesirable. Further, the use of any prohibited names contained in the Emblems and Names (Prevention of Improper Use) Act, 1950 makes the name of a company undesirable.

(*c*) The name of every company and the address of its registered office are to be properly exhibited on the outside of business office and business place.

II. *Situation Clause* : The Memorandum must mention the State in which the registered office of the company will be located. That is, the domicile of the company should be stated for the determination of jurisdiction of the court as well as of the Registrar. Within a particular domicile, there must be a registered office, intimation of which must be given either at the time of registration or within thirty days from the date of registration, provided the company does not commence business earlier than this period of thirty days.

III. *Objects Clause* : (*a*) Any number of lawful objects can be stated and included in this objects clause, whether the company engages in all those activities or not. Any activity which offends the objects clause and is not expressly stated in the Memorandum would be considered *ultra vires, i.e.* beyond the powers of the company ; even the unanimous consent of all the shareholders cannot make such acts *intra vires.* It is found for this reason that objects clause is made very wide and exhaustive by covering all related activities in regard to a particular line of business. Of course, certain acts, powers and objects that are conducive or incidental to the main purpose of the company need not be specifically stated in the Memorandum, and yet, they are taken to be within the implied powers of the company.

(*b*) Companies which are incorporated after 15th October, 1965 are to state their objects divided into two categories—(i) main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects and (ii) other objects of the company not included in the first category.

(*c*) The Act requires that all companies, except a trading corporation, must mention the State or States to whose territories the objects of the company would extend. In other words, areas of operation are to be indicated in this clause.

IV. *Liability Clause* : (*a*) A company limited by shares or by guarantee must state that liability of its members is limited.

(*b*) A guarantee company should introduce a further clause stating the amount of guarantee undertaken by each member towards the liability arising in the event of the company being wound up.

V. *Capital Clause* : The Memorandum of the company having a share capital is required to show the amount of share capital with which the company is going to be registered, and the division thereof into shares of a fixed value. Different classes of shares with varying rights need not be stated in the Memorandum ; this can be done through the Articles.

VI. *Association and Subscription Clause* : Besides the clauses contained in the body of the Memorandum, an association clause signifying the desire of subscribers to form themselves into a body corporate is to be appended in all cases at the foot of the Memorandum. Each subscriber is to take at least one share in the company and is required to state the number of shares taken by him along with his signature.

Alteration of Memorandum. There are different procedures for altering each clause of the Memorandum. Accordingly, it may be discussed separately under the following heads :

Name—With the approval of the Central Government expressed in writing, a company can change its name by a special resolution. Rectification of the name, on the other hand, can be effected by an ordinary resolution and with the approval of the Central Government. In the case of conversion of companies, the word Private can be added or deleted without Government approval. But to make the change of name complete and effective, a fresh Certificate of Incorporation is to be obtained from the Registrar to that effect. Change of name would not affect any rights or obligations of the company and it would not be a bar to any suit against or by the company.

Situation—Change of situation of the registered office of a company from one State to another is effected in the like manner as is required to change the objects of the company. When the change of situation is confined within the jurisdiction of the same State, it can be either of the two types ; (*a*) if the change is confined within the local limits of existing city, town or village concerned, a mere notice within thirty days to the Registrar would suffice for the purpose ; (*b*) but a change of situation outside the local limits of existing city, town or village would require a special resolution as well as a notice to that effect within thirty days.

Objects—Alterations of the objects and domicile of the company are allowed only if such change becomes necessary to enable the

company (*i*) to carry on its business more economically, (*ii*) to use improved means, (*iii*) to enlarge scope and area of operations, (*iv*) to open new business or amalgamate with existing one, (*v*) to dispose of any part of the undertaking, or (*vi*) to restrict or abandon any of its original objectives.

Alteration of the objects clause and of the place of business requires a special resolution of the company as well as confirmation of such resolution by the court. The court may confirm the alteration either in whole or in part and may impose certain conditions in the interests of creditors and members. To make the alteration effective, court's order is to be filed within three months with the Registrar who must register the same within one month thereafter. Moreover, in the case of changing the domicile, the company is required to file with Registrars of two States certified copies of the court's order. And the Registrars in between themselves arrange to get all the documents of the company transferred from one State to another.

Capital—A company limited by shares is permitted to alter its share capital, if authorised by its Articles, in any one of the following ways : (*a*) increase it by issuing new shares, (*b*) consolidate or divide its share capital into shares of any denomination, (*c*) convert fully paid-up shares into stock or reconvert stock into shares, and (*d*) cancel shares that have not been taken up.

Alteration of share capital is required to be passed by an ordinary resolution of the company. A notice of the alteration must be given to the Registrar within thirty days. Particulars of the shares and the conditions attached thereto on the reorganization of shares should be made known to the Registrar. A default in this respect has been made punishable.

Reduction of Share Capital. Reduction of share capital is not tantamount to alteration of share capital. Hence, a different procedure has been prescribed for it. It can be effected by special resolution, notice to the Registrar within thirty days, confirmation by the court and registration of the reduction with the Registrar of Companies. The Registrar, on receipt of copies of the order and the minute, issues a certificate that makes the reduction complete.

ARTICLES OF ASSOCIATION

The Articles of a company contain detailed rules and regulations for management of its internal affairs. They provide the bye-laws governing the conduct of shareholders, directors and other officers of the company, on the one hand, and directing the way in which the objectives of the company, on the other, are to be realized. Briefly,

they contain a comprehensive set of rules for the complete guidance of management personnel of the company.

The Articles once adopted become binding upon all existing and future members of the company. Creditors and other persons having any dealing with the company are also supposed to have notice of the contents of the Articles. The Articles are governed by the Memorandum and cannot go beyond the limits placed in the Memorandum. If any regulation of the Articles offends a provision of the Memorandum, it would become void to that extent.

A public company limited by shares may or may not have any special Articles of its own. In the absence of a separate set of Articles, standard Articles provided in Table A of Schedule I to the Act would apply automatically. For other companies, the Articles of Association must be registered along with the Memorandum. In the drafting of Articles, any and every regulation of Table A may be adopted. Where the framed Articles are silent over some matters, regulations of Table A would govern the case. Further, certain regulations of Table A, such as those relating to the retirement of directors, annual accounts, and declaration of dividend at the annual general meeting, are equally applicable to all types of companies.

Forms and Contents of Articles. The Articles are to be duly drawn up and executed for the purpose of registration. The Articles generally make provisions for the following matters :

a. Appointment, remuneration, powers and duties of top-management personnel.

b. Particulars of interests and rights associated with different kinds of shares ; transfer, transmission and forfeiture of shares ; and calls on shares and alteration of share capital.

c. Sharesholders' and directors' meetings, voting system and the use and custody of the corporate seal.

d. Account and audit, dividends and reserves, borrowing powers, capitalization of profits and winding up of the company.

The Memorandum and the Articles are taken to be public documents which can be seen by members as well as by non-members. A member is entitled to have copies of these documents from the company within 7 days of his request on the payment of a fee of rupee one. Any person can also inspect and make copy of these documents on payment of the same fee from the Registrar of Companies.

Alteration of Articles. The Articles can be altered without any intervention of the court by a special resolution of the company, provided alterations are made *bona fide* and in the interests of the company. The Articles are not allowed to be altered to violate any provision either

of the Memorandum or of the Companies Act. Alterations affecting management require approval of the Central Government in some cases. However, the right to alter the Articles cannot be restricted by any condition laid down therein. Every issue of Articles subsequent to the date of alteration must show the changes made therein.

Memorandum and Articles. The nature of these two documents can be fully explained by drawing a distinction between them in the following ways :

1. The Memorandum is a compulsory document for all companies, but the Articles are optional to a public company limited by shares.
2. Alteration of the Memorandum is to be confirmed by the court ; the Articles can be altered by the members without resorting to the court for confirmation.
3. The Articles are governed by the Memorandum and the Companies Act ; that is, they contain regulations of the 'second order'. The Memorandum embodies regulations of the 'first order' and is controlled by the Companies Act only. In the event of a conflict between the two, provisions contained in the Memorandum prevail over those of the Articles.
4. The Memorandum defines and regulates the relationship between the company and the general public, whereas the Articles regulate the relationship between the company and its members as well as between members themselves.
5. The Memorandum occupies the same position in a company set-up as the constitution does in a democratic State. The Articles may be compared to the different legislative enactments of the Government. This analogy can be carried further ; the board of directors represents the cabinet of ministers and shareholders' meetings stand for the parliament sessions of the Government.

THE PROSPECTUS

The second step in the formation of a public limited company involves the issue of a prospectus. The prospectus is an invitation made to the investing public to buy securities in a company. The Companies Act defines the prospectus as "any document described or issued as a prospectus and includes any circular, advertisement or other document inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate". The object of issuing a prospectus is to stimulate interest and create confidence in the investors ; it depicts the prospects and soundness of the undertaking with a view to inducing them to invest funds in the enterprise. The prospectus being an inducement to collect money, there is a great temptation for

drawing a false and rosy picture of the business in prospectus. It is for this reason, the company law everywhere regulates the issue of prospectus and prescribes the facts and circumstances to be disclosed therein. Matters to be specified in the prospectus under the Companies Act may be briefly stated as follows :

1. *Contents of the Memorandum* with particulars of signatories thereto and of shares subscribed by them.

2. *Number and classes of shares* along with particulars of redeemable preference shares and debentures shown separately.

3. *Rights of shareholders* in regard to capital redemption, voting and dividends on different classes of shares.

4. *Directors' qualification shares and interest of directors* in the promotion of the company as well as in the property acquired within the past two years.

5. *Particulars and remuneration of top-management personnel* comprising the directors and the chief executive.

6. *Restrictions upon members and directors* in respect of voting, transfer of shares and managerial powers.

7. *Minimum subscription* required for the allotment of shares, and the amount payable on application and allotment.

8. *Time limit for allotment of shares* showing the period during which the subscription list would remain open.

9. *Preliminary expenses and underwriting commissions* paid within the past two years.

10. *Details of any premium received on shares and any issue of shares* made for considerations other than cash within the past two years.

11. *Particulars of vendors* of any property and the amount of purchase money paid in cash, shares or debentures along with the amount paid for goodwill to be stated separately.

12. *Nature of material contracts* with the dates of such contracts and parties to such contracts.

13. *Promoter's remuneration* paid in cash or in other forms within the two preceding years and the services received in exchange.

14. *Options and preferential rights* relating to all issues of shares.

15. *Names and addresses of auditors* of the company.

16. *Treatment of reserves and surplus* including the capitalization of such reserves.

17. *Time and place* where copies of balance sheets, profit and loss account and the auditors' report may be inspected.

18. *The fact as to whether a new company or an existing company issues the prospectus* is to be indicated for requiring the company to give suitable valuation report.

19. *Existing company is to furnish a report from the auditor* show-

ing the profit and loss, assets and liabilities and the rates of dividend paid during the past 5 years.

20. *New company is to furnish a report from the accountants* (named in the prospectus) indicating the profits of any business purchased by the company out of its sale proceeds from the issue of shares or debentures.

Issue of a Prospectus. The provisions of the Act are designed to compel the organizers of a company to make full disclosure of all material and important facts relating to the company, so that prospective shareholders can exercise an intelligent judgment over their investments. The issue of prospectus is regulated by the following conditions : (*a*) Every prospectus must state the matters and set out the reports contained in Schedule II to the Act ; compliance with these requirements cannot be waived by any condition contained therein. (*b*) Every prospectus is to be dated, and that date is taken as the date of publication of the prospectus unless proved otherwise ; it is also required to be signed by all the directors or proposed directors. (*c*) It must be registered with the Registrar on or before the date of publication, and every prospectus, when published, is to state on the face of it that a copy has been delivered for registration. (*d*) A prior consent of the Controller of Capital Issues is necessary for all bonus and rights issues. A statement of capital issue proposals is required to be filed with the Controller at least 30 days before the date of offer for other issues of shares and debentures in excess of Rs. 25 lakhs during a period of twelve consecutive months. The fact of consent, if necessary, should be made known in the prospectus. (*e*) The prospectus may contain a statement by an expert, such as professional engineer, valuer, accountant or others, provided such expert does not remain connected with the formation or management of the company. Moreover the expert must give his written consent, the fact of which is to be communicated to the public through the prospectus. (*f*) That personation for subscription to shares is a serious offence is to be indicated in the prospectus. (*g*) A copy of the contract for the payment of commission on the issue of securities is to be delivered to the Registrar.

Liability for Mis-statement. Directors and others responsible for the issue of a prospectus are liable to pay compensation to every person who sustains any loss or damage for an untrue statement contained in a prospectus. "A statement may be false, not only because of what it states, but also because of what it conceals, omits or implies". In other words, a prospectus should not only represent actual facts, but also it must not conceal any material facts which may amount to misrepresen-

tations. Such misrepresentations give rise to a right of compensation as well as a right of repudiation of the contract to take shares on the part of investors. Directors and others are exonerated from this liability, provided they can establish sufficient grounds for non-compliance with or contravention of the requirements of the Companies Act.

Beside the civil liability, directors and others are liable to imprisonment for a term which may extend to two years or to a fine which may extend up to Rs 5,000, or to both. The persons responsible for the issue of the prospectus are only relieved of this liability if they can prove that the statement was immaterial or that there was reasonable ground for believing the statement to be true.

Further criminal liability is imposed upon the directors and others who knowingly or recklessly induce any person by fraudulent means to invest funds in the company. The liability on this count is of more severe character, and the directors are punishable with an imprisonment for a term of 5 years or with a fine of Rs. 10,000, or with both.

Statement in Lieu of Prospectus. A public limited company having a share capital which does not issue a prospectus must deliver to the Registrar for the purpose of registration a statement in lieu of prospectus. This statement has to furnish the particulars contained in Schedule III to the Act, and the contents are more or less the same that are necessary for a prospectus. This statement also must be signed by the directors and registered at least three days before the first allotment. Further, directors are exposed to similar criminal liability for any untrue statement contained therein.

ALLOTMENT OF SHARES

The third step in the formation of a public limited company consists of the allotment of shares. A company cannot proceed to make allotment of those shares which are offered for public subscription unless the following conditions are fulfilled :

1. The minimum subscription stated in the prospectus has been raised from the amount payable on application, and the amount received on application has not been less than five per cent of the nominal value of shares.

2. All monies received from the applicants for shares have been kept deposited in a scheduled bank until they are refunded or a certificate to commence business is obtained from the Registrar.

3. Where a company has not issued a prospectus, a statement in lieu of prospectus has been delivered to the Registrar at least three days before the first allotment.

4. If the minimum subscription cannot be raised within 120 days from the date of issue of the prospectus, all monies are to be returned within the next ten days without the payment of any interest thereon. Thereafter, the directors are jointly and severally liable to repay the application money with interest at the rate of 6 per cent per annum.

5. The Act lays down a minimum time limit before which no allotment can be made. A company should not proceed to make any allotment before the fifth day after the issue of the prospectus or such later time as may be specified in the prospectus under the clause of *the time of the opening of the subscription list.* Any allotment made before this stipulated time limit does not affect the validity of such allotment, but it renders the company and its officers liable to a fine which may extend up to Rs. 5,000.

6. Where a prospectus states that an application would be made to a stock exchange for permitting the shares to be dealt in on the exchange, such application should be made before the tenth day after the issue of the prospectus, that is, within nine days from the date of issuing the prospectus. If the permission is not granted before the expiry of four weeks from the date of closing of the subscription list or such longer time not exceeding seven weeks, then any allotment made on the basis of that prospectus would be deemed void. In case the permission is refused or the company fails to apply for such permission after stating it in the prospectus, the application money should be returned within the next 8 days without the payment of any interest. Thereafter, the directors are jointly and severally liable to repay that amount with interest at the rate of 5% per annum.

Irregular Allotment. Any allotment of shares made in contravention of the requisite conditions is considered irregular. The effect of irregular allotment is to render such allotment voidable at the option of the applicant. The option, however, must be exercised within two months of the statutory meeting or allotment, as the case may be. For contravention of this provision, directors are liable to compensate the company and the allottee for any loss or damage sustained by them. However, the suit is to be filed against the directors within two years from the date of allotment.

Allotment Returns. A company making an allotment of shares is required within thirty days to file with the Registrar a "Return of Allotments". This return should separately state the allotments made under different heads. (*a*) In respect of shares allotted for cash, the return must mention the number and the nominal value of shares allotted, and particulars of the allottees together with amount paid by them on each share. (*b*) In respect of shares allotted for consideration other than

cash, the return must state the number, nominal value and paid-up value of shares so allotted as well as the consideration for the allotment of shares. Contracts with the allottee are required to be produced before the Registrar for inspection and record purposes. (*c*) For issue of bonus shares, the return should state the number and nominal value of shares allotted together with the particulars of allottees and a copy of the resolution authorising the issue of such shares.

COMMENCEMENT OF BUSINESS

The fourth and the final step in the formation of a public limited company is to secure the 'Commencement Certificate' or the certificate to commence business. In the case of a public limited company which has issued a prospectus, the Commencement Certificate is issued on the fulfilment of the following conditions :

1. Shares covering the minimum subscription have been allotted and the minimum subscription has been raised entirely in cash from the application money.
2. The directors have paid the same proportion on their shares as the public have been required to pay on application and allotment.
3. No money is repayable to the applicants for shares or debentures by reason of the failure to apply for, or to obtain permission for trading in securities on any recognized stock exchange.
4. Except the main objects or the objects incidental to the attainment of main objects, the commencement of business in any other objects must be approved by a special resolution of the company in general meeting.
5. Statutory declaration by one of the directors or the secretary to the effect that necessary conditions have been complied with.

Where a public limited company does not issue a prospectus, it has to secure the Commencement Certificate on the following grounds:

a. A statement in lieu of prospectus has been filed with the Registrar.

b. Every director has paid or has agreed to pay in cash the same proportional amount payable on application and allotment as others have paid.

c. Commencement of business in any other objects not germane to the main business has been approved by a special resolution of the company in general meeting.

d. Statutory declaration by one of the directors or the secretary has been filed with the Registrar stating the compliance with requirements of the Act.

The Commencement Certificate should be obtained by all companies except private limited companies. A guarantee company without a share capital has to observe all the formalities except those which relate to shares only. A public limited company is entitled to commence business only after the receipt of this certificate.

Minimum Subscription. It is the minimum amount which in the opinion of the Board of Directors should be raised in cash from the application money. The minimum amount to be collected from the public through the share subscription is known as minimum subscription. It is to be stated in the prospectus showing the amount required for each of the following purposes separately :

1. *The purchase price of any property acquired or to be acquired.*
2. *Preliminary expenses and commission payable on shares.*
3. *Repayment of loans made for the above two requirements.*
4. *Working capital.*
5. *Any other expenditures stating the nature and purpose thereof separately.*

CHAPTER 5

REGULATION OF COMPANY FORMATION

HISTORY OF COMPANY LAW IN INDIA

The first company law in India was passed in 1850 on the model of the English Companies Act of 1844. The Act of 1850 was passed for the registration of joint-stock companies with unlimited liability. The principle of limited liability was introduced in 1857 in all companies other than banking and insurance companies. The privilege of limited liability was extended to all banking and insurance companies after three years by an Act passed in 1860. A number of amendments were made for improving the company law up to the year 1913 when a comprehensive Act was passed. The Act of 1913 introduced for the first time in our country two important developments in company law ; first, a distinction between the public limited company and the private limited company was made by that Act, and secondly, company management through a Board of Directors was made obligatory for all companies. But the new Act was silent about the peculiar institution of company management, namely, managing agents which was brought under statutory control by amending the Act in 1936. By this amendment, the Indian Companies Act, 1913-36 was brought in line with the English Companies Act of 1929. Thorough overhauling and recasting of the Act of England were made by the passing of the English Companies Act, 1948. Consequently, necessity arose in our country for changing the company law which closely followed the developments in England during the pre-independence period. After the independence of the country, public demand became insistent over the matter.

A twelve-man committee was appointed for reforming the company law in India in the year 1950, and the report of the Company Law Committee (Bhabha Committee) was published in March, 1952 with a suggestion for radical changes in the powers and duties of management personnel as well as in the rights and interests of shareholders. On the recommendations of the Committee, a mammoth and complex piece of legislation comprising 658 sections and 12 schedules as against 290 sections with 3 schedules to the old Act, was passed in the year 1956. The Companies Act, 1956 came into force from 1st April, 1956. The Act has been amended several times.

Desiderata and Objectives of the Reform. The Companies Act, 1956, is based on three important considerations. *First,* the abuses and malpractices of company management which could not be eliminated by the amending Act of 1936 were required to be stopped by the drafting of a suitable statute as well as by the setting up of an effective administrative machinery. *Secondly,* the State must protect the legitimate interests of the investors and create confidence in them so that capital formation was facilitated. *Thirdly,* the adoption of a socialist pattern of society made it imperative on the part of the State to see that private industrial enterprises through the corporate forms were guided not only by profit motive, but by social gain as well.

The Bhabha Committee indicated the broad social and economic perspectives in which the company law reform was to be viewed. The Committee observed that "the objective of the reform is to adjust the structure and methods of working of the corporate form of business management with a view to weaving an integrated pattern of relationships as between promoters, investors and the management, so that—

a. The efficiency of the corporate form of organization may be increased (as measured by accepted standards);

b. managerial efficiency may be reconciled with the legitimate rights of investors ;

c. the interests of creditors, labour and other partners in production and distribution may be duly safeguarded ; and

d. the attainment of the ultimate ends of social policy is helped and not hindered by the manner in which the corporate form of business organization works in this country."

AMENDMENTS TO THE COMPANIES ACT, 1956

After the enforcement of the Companies Act in April 1956, several amendments have been effected. Of all such amendments, the Companies (Amendment) Act, 1965 introduced some significant changes in the company law of India. Again, the Amending Act of 1969 introduced a far-reaching change by the total abolition of the managing agency system.

The Companies (Amendment) Bill, 1972. For preventing serious abuses and distortions in the working of corporate enterprises, the Companies (Amendment) Bill was introduced in August 1972 in the Lok Sabha and is now before a Joint Select Committee of the Parliament. The Bill seeks to amend not only the Companies Act, 1956, but the Securities Contracts (Regulation) Act, 1956 and the Monopolies and Restrictive Trade Practices Act, 1969 as well. The salient features of the Bill are as follows :

1. *Widening of the coverage of Section 43A private limited companies*—A private limited company would be deemed to be a public limited company in three different cases, *viz.*, (*i*) where 10 per cent of its paid-up capital is held by one or more companies, (*ii*) where it has a paid-up capital of Rs. 25 lakhs or more and an average turnover of Rs. 50 lakhs or more during the previous three financial years, and (*iii*) where it holds not less than 10 per cent of the paid-up capital of a public limited company.

2. *Restrictions on share transfer and management take-overs*—No individual, group or company can acquire (*a*) more than 25 per cent of the capital of any public limited company with a paid-up capital of over Rs. 25 lakhs or any of its subsidiary and (*b*) also shares constituting 10 per cent or more of the capital of a foreign company operating in India without the previous approval of the Government. Wherever a change in the controlling interest of the company would be prejudicial to the interest of the company or the public, the Government would prevent the transfer of shares. Particularly in the case of companies holding 10 per cent or more of the equity share capital of any other company, any transfer of shares out of such holding is prohibited without prior intimation to the Government.

3. *Restrictions on benami holdings of shares*—A registered shareholder who is a *benamidar* should make a declaration to the company specifying the name and other particulars of the beneficial owner of such a share. Similar declaration should also be made by the beneficial owner within specified time, and failure to do so would be punishable with fine. All collateral agreements made in connection with such unreported *benami* holdings would become unenforceable. Provisions have been made for investigating cases of *benami* holding of shares.

4. *Rules for dividend payment*—Dividends are to be declared out of reserves only in accordance with the prescribed rules. Within seven days from the date of dividend declaration, the companies would require to transfer the total amount of dividend to a special account in any scheduled bank. Dividend amount remaining unpaid or unclaimed for three years would come in the hands of the Government for paying the individual claimants thereafter.

5. *Appointment of more than two directors by the Government*—With a view to safeguarding the interests of the company and its shareholders, the Government would have powers to appoint more than two directors on the board of a company, to give directions to the company and to ask the directors to submit report to the Government.

6. *Regulation of foreign companies*—When more than 50 per cent of the share capital of a foreign company is held by Indian citizens or Indian companies, such a foreign company would be treated as a company incorporated in India and the provisions of the Act relating to inspection and investigation would apply to it.

7. *Other amendments*—Other important amendments proposed in the Bill include the comprehensive definition of the companies under the same management, regulation of the appointment of sole selling agents, consultants, advisers, secretaries and auditors, regulation of the appointment, reappointment and remuneration of managing or whole-time directors, requirement of companies having a paid-up capital of over Rs. 25 lakhs for appointing a whole-time secretary with prescribed qualifications, increase in Government's power of inspection of the books of account of any company, regulation of acceptance of deposits by companies, alteration of the company's Memorandum for increasing share capital in case of conversion of loans into equity, etc.

REGULATORY MEASURES AS TO FORMATION

Regulatory measures of the Companies Act, 1956, relating to company formation may be studied under the following four heads :

1. **Prospectus.** The prospectus has been made a formidable statement containing much greater detailed information so that it can show the prospects and soundness of the concern in clear terms. It embodies the stringent requirements of the best stock exchange practices existing in the U. K. and the U. S. A. The responsibility of making a full and fair disclosure of all material facts has been thrusted upon the promoters and directors under a severe penalty for non-compliance. The prospectus is now required to disclose two additional particulars—(*a*) previous written consent of the experts whose opinion is cited in the prospectus and (*b*) copies of all material contracts concluded with promoters, vendors and others within the past two years.

Apart from these particulars, there are other important matters that deserve special mention.

i. The *minimum subscription clause* has been tightened up to avoid the starting of companies with an insufficient capital. Underfinancing was comparatively easier under the old Act, since it permitted to state the minimum subscription in one consolidated amount.

ii. The *allotment* procedure has been altered under the Companies Act. A minimum time limit has been placed for the first time, and the maximum time has been reduced from 180 days

to 120 days. Between these two limits, the actual period during which applications for shares are to be received may be determined by the company. The minimum time limit has two advantages ; it checks the activities of 'stag' speculators, and it gives a reasonable time to the investors to study the prospectus critically. Subscription lists of many companies in the past were closed within the course of a single day. Consequently, safety and security of investment were sacrificed to hurry in some cases, and in many others, the public limited company became a closely-held concern.

2. Administrative Machinery. The setting up of an appropriate and effective administrative machinery is the most important measure for ensuring the formation of sound companies. Even the most well-conceived and well-designed law is liable to become ineffective and fall into disrepute if there is no regular machinery for making any use of it. It was precisely the same fate that the old Act of 1913-36 had to face, and the failure of that Act could be ascribed not so much to the absence of powers therein as to the lack of their use. Every State has been provided now with a Registrar who guides the company from the womb to the tomb.

3. Listing of Securities on a Stock Exchange. For the purpose of permitting the securities to be dealt in on a stock exchange, the securities are required to be listed on a particular stock exchange. To be included on the list of securities, applications are to be made before the 10th day after the issue of prospectus, and necessary permission is to be obtained within the first four weeks or a further extended time of seven weeks. Security listing has proved to be a potent instrument for preventing the growth of mushroom and fraudulent companies in the developed countries of the world. With the enforcement of stock exchange reforms, the recognized stock exchanges only are now operating in the country, and the managing committees of all stock exchanges are required to have some Government representation on them. Furthermore, companies desiring an official quotation on recognized stock exchanges are now compelled to offer at least 49 per cent of the issued capital to the public for subscription. It is logical to expect, therefore, that security listing provision would exert a similar powerful influence over the company formation in our country.

4. Sanction of Capital Issues Control. Except any bonus issues and rights issues at a premium which require the prior consent of the Capital Issues Control, all other capital issues exceeding Rs. 25 lakhs during a period of 12 consecutive months call for filing a statement

of such capital issue proposals to the Controller of Capital Issues at least 30 days before the date of the public offer. Before 1956, control over capital issues was exercised in a half-hearted measure which resulted in the frustration of the very object for which it was designed. Since April, 1956, the Controller of Capital Issues is enforcing the statutory requirements of the Companies Act relating to capital issues and is requiring the companies to adopt a sound and balanced capital structure. Hence, the scrutiny of capital issues is likely to foster a healthy growth of the corporate sector.

In addition to the prospective shareholder, the prospectus is thus examined by three different bodies, *viz*. (*a*) Registrar of Companies, (*b*) Controller of Capital Issues, and (*c*) the stock exchange governing body.

COMPANY LAW ADMINISTRATION

The Indian Companies Act of 1913-36, being a Central Act, should have been administered by the Central Government. But the Central Government abdicated its responsibility for the task, and the powers of Company Law Administration were vested in the State Governments. The State Governments took the matter very lightly and the work of company registration was carried on by part-time officers assisted by their part-time staff in most of the States. Whole-time Registrars were appointed in the States of West Bengal and Bombay only. Registrars' offices became virtually the filing offices, and the sole duty of the Registrar was to receive a few statutory returns and to hold custody over them. Commenting upon this system of administration, the C. L. C. observed that 'the Indian Companies Act was perhaps the most under-administered of the Central Acts relating to trade and industry."

On the recommendations of the Company Law Committee, the Central Government assumed control over the Registrar and his staff from 1st January, 1955, and a central Department of Company Law Administration was established in August, 1955, both before the enforcement of the Companies Act, 1956. A three-tier administrative machinery has been set up for the administration of company law. At the bottom of the machinery lie the Registrars whose duty is to register the companies as well as to deal with the documents and returns submitted by the operating companies. Above the Registrars, there are four Regional Directors who direct, supervise and co-ordinate the activities of Registrars, on the one hand, and form local arms of the Central Government, on the other. A new Company Law Board in replacement of the Department of Company Law Administration has been placed over the organization with an overall responsibility for company law administration.

Functions of Registrars. In all the capitals of the States, there is now a Registrar of Companies with whom companies can be registered. Registrars are supposed to perform three important functions : *first,* they preserve the vital documents relating to all companies in their respective States, and these documents are available for inspection by members as well as by non-members of the company. *Secondly,* Registrars encourage proper working of the company by the requirement of punctual submission of reports and returns from all companies. *Thirdly,* Registrars scrutinise the contents of the returns so as to find their compliance with the law. If they suspect anything wrong with the affairs of the company, they can consult the Regional Directors, call for further information and explanation from the company, or refer the matter to the Company Law Board for the purpose of investigation by inspectors.

Regional Directors. Four offices of Regional Directors have been established at Calcutta, Bombay, Madras and Kanpur with the object of forming a link between Registrars and the Central Government as well as between the Central Government and the State Governments. Relieved of the routine work, they can keep the Board informed of all new developments in company practices and company management. By this arrangement corrective measures can be taken without making an undue delay, and thus unfavourable developments can be speedily checked.

Company Law Board. In replacement of the Department of Company Law Administration, the Board of Company Law Administration has been organized as a part of the Department of Company Affairs with effect from March 1967. The newly created Department of Company Affairs is in charge of the Company Law Division along with the administration of other relevant statutes. Although the Company Law Board is not an autonomous body like the Securities and Exchange Commission of the U.S.A., still it makes an improvement over the old arrangement by facilitating administrative co-ordination with other related statutes in respect of corporate enterprises.

Company Law Advisory Committee. The Statutory Advisory Commission which was created by the Indian Companies (Amendment) Act, 1951, has been replaced by the Advisory Committee under the provisions of the Companies (Amendment) Act, 1965. For advising the Central Government or the Company Law Board on such matters as may be referred to it, the Committee may be constituted by not more than five persons with suitable qualifications.

Working of Companies. The Annual Reports on the Working and Administration of the Companies Act, 1956 contain a detailed analysis of the working of established and new companies in recent years. From such analysis, the following five tables are provided for explaining some important aspects of company formation and operation :

NON-GOVERNMENT COMPANIES AT WORK

(Amount in crores of rupees)

Year ending 31st March	Private Ltd. Cos.		Public Ltd. Cos.		Total Companies	
	No.	Paid-up Capital	No.	Paid-up Capital	No.	Paid-up Capital
1968	20,606	430.2	6,497	1,684.4	27,103	2,114.5
1969	21,260	433.4	6,454	1,712.0	27,714	2,145.4
1970	22,242	447.1	6,436	1,740.6	28,678	2,187.7
1971	23,655	461.8	6,443	1,775.1	30,098	2,236.9
1972	25,639	483.5	6,571	1,800.1	32,210	2,283.6

NEW NON-GOVERNMENT COMPANY REGISTRATIONS—1967-68 TO 1971-72

(Amount in crores of rupees)

Year ending 31st March	Private Ltd. Cos.		Public Ltd. Cos.		Total Companies	
	No.	Authorised Capital	No.	Authorised Capital	No.	Authorised Capital
1968	965	51.9	70	55.5	1,035	107.4
1969	1,041	50.7	61	129.9	1,102	180.6
1970	1,384	86.2	103	130.1	1,487	216.3
1971	1,783	117.4	112	90.1	1,895	207.5
1972	2,310	179.6	183	148.3	2,493	327.9

GOVERNMENT COMPANIES AT WORK

(Amount in crores of rupees)

Year ending 31st March	Private Ltd. Cos.		Public Ltd. Cos.		Total Companies	
	No.	Paid-up Capital	No.	Paid-up Capital	No.	Paid-up Capital
1968	169	1,460.2	72	99.1	241	1,559.3
1969	178	1,593.0	81	121.9	259	1,714.9
1970	201	1,660.4	81	130.2	282	1,790.6
1971	223	1,931.3	91	133.2	314	2,064.5
1972	245	2,213.1	107	156.0	352	2,369.1

NEW GOVERNMENT COMPANY REGISTRATIONS—1967-68 TO 1971-72

(Amount in crores of rupees)

Year ending 31st March	Number	Authorised Capital
1968	9	70.0
1969	13	69.3
1970	23	56.7
1971	32	125.6
1972	31	196.5

NEW COMPANIES AND DEFUNCT COMPANIES—1967-68 TO 1971-72

Year ending 31st March	Number of New Registrations	Number of companies ceasing to work
1968	1,044	627
1969	1,115	588
1970	1,510	523
1971	1,927	472
1972	2,524	361

CAPITAL ISSUES CONTROL

Control over capital issues was introduced for the first time in India in May, 1943 as a war-time measure under the Defence of India Rules. The main purpose of this control was to prevent diversion of available investible funds for activities that made little or no contribution to the prosecution of the war, and the secondary purpose was to maintain the production of essential goods and services for meeting the requirements of consuming public. But the control measure was continued even after the war to combat inflation which showed no signs of abatement at that time as well as to secure a balanced and equitable investment of the country's resources in the economic life of the nation. With these ends in view, the control measure was prolonged first by the issue of an ordinance and thereafter by the passing of the Capital Issues (Continuance of Control) Act, 1947 up to March, 1950. In the mean time, the advent of Five-year Plans made the continuance of this control to be of paramount importance. Accordingly the life of the Capital Issues (Continuance of Control) Act, 1947 was extended from time to time to March, 1956, when this piece of legislation was made permanent in character.

At present, the Capital Issues Control is exercised for realizing three objectives. *First,* the flow of investment is to be directed towards the socially desirable fields, particularly those industries which fall within the limits of Five-year Plans. *Secondly,* the control is to see that corporate enterprises develop a sound capital structure by avoiding over-and under-capitalization, maintaining proper ratio between equity and debt, and adopting other practices of good financial management. *Thirdly,* it has to provide necessary checks and balances in the matter of capital issues. The timing and amount of capital issues are to be co-ordinated with those of Government's borrowings, the interests of investors are to be safeguarded in all capital issues, and the terms and conditions of capital issues are to be brought in conformity with the provisions of the Companies Act.

Under the Act, capital issues mean all offers of shares and debentures beyond a prescribed financial limit made by public limited companies including the amount derived from capitalizing profits and reserves, crediting partly paid-up shares as fully paid-up shares and enhancing the par value of shares issued previously with a lower face value. Irrespective of the amount of issues, the bonus issues by all companies and the rights issues at a premium by public limited companies have been brought under the purview of this control. Except

with the consent of the Central Government in appropriate cases, the Act prohibits the following activities pertaining to capital issues :

1. To make an issue of capital outside India by any company incorporated in India.
2. To make an issue of capital in India by any company, whether incorporated in India or not ;
3. To make any public offer of securities for sale in India through prospectus or other means ;
4. To renew or postpone the date of repayment of any security maturing for repayment in India ;
5. To give or accept any consideration on the part of a person for capital issues made in India.

The exemption limit for securing consent of the Government has been varied from time to time. Before December 1963, all issues of capital not exceeding Rs. 10 lakhs made within a period of twelve consecutive months were exempt from control. In December 1963, the exemption limit was raised from Rs. 10 lakhs to Rs. 25 lakhs. In February 1969, the Government announced a major relaxation in capital issues control through the Capital Issues (Exemption) Order, 1969. Under the new requirement, the public limited companies making capital issues exceeding Rs. 25 lakhs during a period of twelve consecutive months are to file a statement only to the Controller of Capital Issues at least thirty days before the date of the proposed offer. Such proposals are accepted provided they conform to certain established standards like proper debt-equity ratio, equity-preference ratio, fair rates of return on securities, capital issues at par, etc. But the Government has retained full control without any exemption limit over bonus issues by all companies and rights issues at a premium by public limited companies.

Working of the Capital Issues Control. The Control is exercised by the Ministry of Finance, the Government of India, through the Controller of Capital Issues. The Controller is aided by an Advisory Committee composed of five non-official members with wide experience and knowledge. The working of the Control was very unsatisfactory in the past. Much improvement has been effected in recent years, and with the assistance of the Advisory Committee, many of the deficiencies in its working have been overcome. But unnecessary delay in giving permission for capital issues acts as a brake to the formation of new companies. The new issue activity in the capital market in recent years is indicated by the following table.

CAPITAL ISSUES OF NON-GOVT. PUBLIC LIMITED COMPANIES

(Amount in crores of rupees)

Year ending 31st December	Capital Consents other than loans and bonus issues	Capital Issues other than bonus issues	Capital Raised Other than loans and bonus issues
1968	87.4	68.4	83.9
1969	84.9	58.2	80.1
1970	48.5	66.4	75.4
1971	84.9	43.3	64.0
1972	111.9	92.9	99.0

GROWTH AND SIGNIFICANCE OF PRIVATE LIMITED COMPANIES

The concept of private limited companies was introduced first in Germany in 1892 by exempting such companies from some of the rigorous provisions of the company law that were required to be observed by public limited companies. The English Companies Act of 1907 initiated this distinction between the public limited and the private limited companies. In our country, it was the Indian Companies Act, 1913 which adopted for the first time this basis of distinction between public limited and private limited companies. The Companies Act, 1956 has gone a step further in depriving the private limited companies of their four available exemptions regarding name, number of directors, statutory audit and filing of balance sheet with the Registrar. The amendment to the Companies Act in 1965 places a further restriction on the privileges and immunities of private limited companies. Despite an encroachment upon their privileges and exemptions, the new company law permits the private limited companies to enjoy a large measure of freedom. As a matter of fact, the regulatory measures of the Act are designed mainly against public limited companies. The reason for this differential treatment lies in the fact that shareholders of a private limited company are likely to be acquainted with one another and that ownership of the company is not usually separated from its management. In many cases, partnership concerns set themselves up in a business under the form of private limited company for avoiding the burden of unlimited liability. Accordingly, the investors do not require the same amount of protection from the side of the State as is necessary in the case of public limited companies. Furthermore, the size of the business being small in most cases, any rigid and strict regulations are not required for the situation.

However, the growth of private limited companies is not as much high in our country as it is to be found in the U.K. The steady growth of private limited companies in the private sector in India is indicated by placing the number and share capital of total limited companies and private limited companies side by side in the following table :

NON-GOVT. PRIVATE LIMITED COMPANIES AT WORK

(Paid-up Capital in crores of rupees)

Year ending 31st March	Total Ltd. Cos.		Private Ltd. Cos.		Percentage of private Ltd. Cos. to total Ltd. Cos.	
	No.	Paid-up Capita	No.	Paid-up Capital	No.	Paid-up Capital
1968	27,103	2,114.5	20,606	430.2	76.0	20.3
1969	27,714	2,145.4	21,260	433.4	76.7	20.2
1970	28,678	2,187.7	22,242	447.1	77.5	20.4
1971	30,098	2,236.9	23,655	461.8	78.6	20.6
1972	32,210	2,283.6	25,639	483.5	79.6	21.2

Privileges of Private Limited Companies. In the grant of privileges, the Companies Act has drawn a distinction between independent private limited companies and other private limited companies which are subsidiaries of some public limited companies. For these subsidiary private limited companies, some privileges have been withdrawn on the ground that such private limited companies assume the character of public limited companies. As it is in the sphere of management alone that some restrictions have been placed on private limited companies of the subsidiary type, the privileges and obligations of private limited companies as compared to public limited companies may be studied in general for avoiding complications.

1. A private limited company can be formed by two persons, and it is not required to file a prospectus or a statement in lieu of prospectus.

2. There is no restriction on the commencement of business.

3. There is no necessity of statutory meeting and statutory report.

4. Further shares need not be offered to the existing shareholders *pro rata,* i.e. shareholders are not entitled to a right of pre-emption.

5. It can issue deferred and other classes of shares with disproportionate voting rights. Moreover, it can give financial assistance to any person for the purchase of its own shares.

6. Shareholders have no right of appeal against management which refuses to register their transfer of shares.

7. Operation of law relating to meeting procedure may be excluded by the provision in its Articles. A proxy in a private limited company has the same right as the member and he can speak on behalf of a member. Quorum for a meeting may consist of two members, and poll can be demanded by a smaller number of members.

8. It is not required to file with the Registrar the written consent to act as directors at the time of incorporation. Number of directors can be increased without Government approval, and a director holding office for life on 1st April, 1952 cannot be removed.

9. Several restrictions placed on directors of a public limited company in respect of (*i*) number of directorship and managing directorship, (*ii*) share qualification, (*iii*) loans to directors, etc., do not apply to it.

10. Approval of the Central Government is not necessary relating to the appointment of managerial personnel, changes in the constitution of the board or in the powers of directors.

11. Managerial remuneration provision does not apply to a private limited company.

12. The Central Government cannot prevent a change in its management under any circumstance.

Obligations of Private Limited Companies. Obligations of private limited companies have been enlarged under the new company law and they are stated as follows :

1. Its name must end with two words "Private Limited".

2. It must submit a separate set of Articles of its own at the time of registration.

3. The accounts of a private limited company are required to be audited by qualified auditors.

4. Annual return is to be filed with the Registrar together with 3 copies of balance sheet, profit and loss account and the auditor's report.

5. It must have at least two directors.

6. Shareholders must not appoint more than one person as proxy to attend any one meeting.

7. It has to file a statement with the Registrar (along with the annual return) showing that no public invitation for shares and debentures has been made and that number of members does not exceed fifty.

8. Share transferability being restricted, it cannot issue share warrants.

9. A private limited company becomes a public limited company under Section 43A of the Companies Act in those cases where not less than 25% of its paid-up share capital is held by one or more companies, at least one of which is a public limited company. But private limited companies do not become public limited companies as such, provided that their entire paid-up share capital is held by one or more foreign companies, or that all the shareholding companies are private limited companies owned by individuals not exceeding fifty in all.

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 3 : OWNERSHIP FORMS OF BUSINESS

1. Discuss the advantages and disadvantages of the sole proprietorship as a form of business.

2. Explain the significance of the statement—"Although the sole proprietorship accounts for the largest number of business establishments in any country, there are strict limits beyond which it cannot grow."

3. Discuss the nature of partnership in the light of its salient features.

4. Discuss the important clauses of a Partnership Deed.

5. What are the rights and obligations of partners in a partnership business?

6. Write notes on—(*a*) Registration of Firms, (*b*) Kinds of Partners, and (*c*) Types of Partnership.

*7. Discuss the advantages and limitations of partnership as a form of business.

8. How does a limited partnership differ from a general partnership? What are the merits and defects of limited partnership?

*9. Discuss the main points of distinction between a partnership business and a joint Hindu Family business.

10. What are the three outstanding features of companies that have made them a unique form of business for conducting large-scale operations?

11. How does a limited company differ from a partnership as a form of business?

*12. Discuss briefly the advantages and disadvantages of a company as a form of business.

13. What are the distinctive features of a co-operative society as a form of organization? Distinguish between the co-operative and the company.

14. Classify the co-operatives into certain broad groups and point out their merits and defects in general.

15. Trace the growth of co-operatives in India and indicate the recent measures adopted for their development.

*16. Set out the important considerations in choosing a form of business.

Chapter 4 : Promotion and Formation of Companies

17. Discuss the role of promoters in the industrial growth of a country. State the important steps in promotion.

18. What are the different types of companies from the standpoints of their incorporation and the nature of their liability?

19. State the requirements of the Companies Act for registering companies limited by shares.

*20. What do you understand by the Memorandum of Association? How does it differ from the Articles of Association? Discuss the contents of both.

*21. What is a prospectus and why is it issued? State any ten of the important matters that every prospectus should contain.

*22. What are the steps involved in the floatation of a public limited company from registration to the commencement of business?

23. Write notes on—(*a*) Incorporation Certificate, (*b*) Commencement Certificate, (*c*) Minimum Subscription, (*d*) Allotment Returns, (*e*) Statement in lieu of Prospectus, and (*f*) Liability for mis-statements in Prospectus.

Chapter 5 : Regulation of Company Formation

24. Trace the historical development of company law in India from 1850 to 1970.

*25. What are the broad measures incorporated in the Companies Act for ensuring sound company formation in India and protecting investors' interests?

26. What have been the changes introduced in the prospectus by the Companies Act, 1956?

27. Describe the organizational arrangements that have been made by the Government for administering the new company law in India.

*28. What do you understand by Capital Issues Control? Discuss the need for, and the manner of exercising control at the present time. Give a brief idea of the working of this control.

29. What are the identifying marks of private limited companies and what are their comparative advantages over public limited companies?

30. Discuss the significance of private limited companies in the corporate sector of business enterprises. State the privileges and obligations of such companies under the provisions of the Companies Act, 1956.

PART THREE—CORPORATE MANAGEMENT

CHAPTER 6

COMPANY MANAGEMENT AND THE BOARD OF DIRECTORS

NATURE OF COMPANY MANAGEMENT

In managing companies, the fundamental authority rests with the shareholders who have the right of ownership, and along with it, the power of management and voting. But the shareholders for their residing in different places and being unacquainted with one another are not in a position to exercise the powers that they legally possess. The company law, therefore, authorises the shareholders to delegate their powers of management to directors who are periodically elected by them. All the directors taken together constitute the board of directors, and the board is the ultimate executive authority in the company and exercises almost all powers of company management. Some matters of special importance affecting the interests of all, such as alteration of the Articles and Memorandum, sale or lease of the assets and change in the capital structure cannot be carried out without the approval of shareholders.

The earlier concept of company management as to that directors are merely agents of the company has been discarded long ago. With the growing complexity of modern business and the progressive development of the corporate form of organization, day-to-day management of companies has been increasingly entrusted to directors. Directors are the elected representatives of the shareholders, and they are to assume the powers and duties as set forth in the Articles of the company. The present position of directors is that they alone, acting as a board, can manage the company's affairs ; and the shareholders cannot take up management of the company by driving out the directors. In cases of dissatisfaction with the present directors, the only remedy available to shareholders is to elect a new set of directors at the annual general meeting. In short, the company must be managed in all cases by the directors.

Directors are general managers of the business and are concerned with the mapping out of basic objectives and policies. The details of management are left to the different forms of chief executives like managing directors or managers who decide matters in the interval between

two meetings of directors and who stand at the head of operating management personnel. These management personnel are subordinate to the board of directors and have the powers given to them either by the Articles of Association or by the board of directors. Briefly, the ordinary questions that arise in business are settled by the salaried managers who constitute the team of operating management or middle management. More important questions are referred to the managing director or other forms of the chief executive who are concerned with the interpretation of policy laid down by the board of directors, and who guide the entire process of executive control as the active part of top management. Larger questions of objectives of the business and its policy are kept for the directors to be decided by them at the board meetings which usually take place once a month. Questions of special importance are thrashed out at the annual general meetings of shareholders. That is, the board of directors formulates the basic objectives and policies, the chief executive translates the policy into specific orders and instructions, and departmental or sectional managers execute the policy and orders.

PROBLEMS OF COMPANY MANAGEMENT

All problems in corporate management have stemmed from the separation between ownership and management. Theoretically, the ultimate control is vested in shareholders who hold the voting powers. Directors and others should submit to the will of shareholders. In a small company, this relationship may exist between the shareholders and the management team. But in a large company, the elements of ownership and management tend to become divorced from each other due to certain factors. Ownership lies with the general body of shareholders, whereas control is usurped by a handful of shareholders who become directors. Shareholders having a risk of their investments in the company cannot direct its affairs for the purpose of making a fruitful use and preservation of their investments. The practice goes against the very institution of private property which requires that "where the risk lies, there the control lies also." As a result, company management is carried on arrogantly by the directors who may not be inspired to serve the best interest of shareholders. Although the directors usually hold a substantial block of shares in the company, yet that amount is reduced to an insignificant part in terms of total investments.

Reasons for Separation of Ownership and Management. The company setting is conducive to a considerable separation of ownership from management for the following reasons :

a. Non-voting shares—By the introduction of different classes of shares with varying voting rights, a large section of shareholders is kept out from having any voice in managing companies. Under the existing company law, the preference shareholders are denied this voting right in the normal conduct of business. It is the equity shareholders who alone possess the right to elect directors for management of the company's business. Previously, companies could have issued another class of shares with disproportionate voting rights, namely, deferred shares. Furthermore, debenture holders who provide funds to the company are never allowed to take any part in managing the business unless their interests are in serious danger. The net effect of this arrangement is that directors are elected by a certain favoured section of investors, not by all of them.

b. Registered equity shareholders—The equity shareholders whose names appear in the company's books at the time of the annual general meeting are only entitled to cast votes for the election of directors. The share transfer book is closed much in advance of the general meeting, and consequently, many owners of shares may not get their names registered in the company's book. It results in the shutting out of a group of equity shareholders from having any say in the election of directors.

c. Dispersal of shares and proxy voting—Equity shareholders in a large company are generally scattered throughout the length and breadth of the country, to be more accurate, throughout the world. It is obvious, therefore, that all the shareholders cannot attend the company meetings in person. To collect the votes of such absentee shareholders, the proxy forms are sent out to eligible members under the advice of the existing board of directors. Some of the proxy forms are duly returned to the company, and others are thrown in the waste paper basket, since there is no compulsion to cast votes through attendance either in person or by proxy. The illusory character of shareholders' control reaches its climax when the proxy votes come into the hands of a special committee appointed by existing directors. It is needless to point out that proxy votes which appear favourable to the directors may be counted and unfavourable votes may be destroyed without any chance of detection.

d. Ineffective company meeting—Even when some shareholders attend the company meetings, they cannot raise an effective voice against existing management. Shareholders are presenting an ever-changing constituency by the transference of shares. Directors elected by one group of shareholders may guide the destiny of the company composed of an entirely different group of investors. Moreover, directors are responsible to the majority of shareholders present in person or by proxy. Since most of the shareholders play a passive role

at the company meeting, they cannot unite themselves with the object of presenting an organized opposition to directors.

It is a great perversion of truth to say that directors are shareholders' representatives. In actual practice, they are self-chosen or chosen by an inner ring of shareholders. Shareholders have no alternative but to elect the directors whose names are presented before them at company meetings. Further, once appointed to control the affairs, they can continue their directorship through an automatic reappointment. In brief the democratic process of company management appears to be a stupendous myth or a fantastic lie.

REGULATORY MEASURES AS TO MANAGEMENT

Regulatory measures are directed, on the one hand, to increase shareholders' control over the working of companies, and on the other to restrict the powers of management personnel for the purpose of eliminating their abuses and malpractices.

Shareholders' Control. Attempts have been made in the Companies Act, 1956 to secure for the shareholders some increased powers of control over company management in the following ways :

1. *Fullest possible disclosure of facts*—The working results of the company are to be disclosed to the members of the company without any reservation. Every member of the company is entitled to receive 21 days' prior notice of the annual general meeting along with the copies of balance sheet, profit & loss account, auditor's report, directors' report and chairman's speech. Any default in this respect has been made punishable under the law.

2. *Shareholders' association*—The character of shareholders' association boils down to the voting trust of the U.S.A. With the object of making an intelligent and proper use of proxy votes, the Board of Company Law Administration is banking upon the growth and development of shareholders' association. Such an association will obviate the necessity of individual attendance and will look after their group interests.

Unlike the voting trust, this association would not be organized by the minority group to gain control over the company. It would be an association formed by disinterested general shareholders who are not likely to take the trouble and expense of sending their proxy votes to the association. Secondly, the cost of sending thousands of proxy forms through the mails cannot be met by the association. Lastly, the existing management teams of different companies may indirectly gain control over it so as to bring its usefulness to a nullity. In short, it will meet the same fate as the consumers' associations have done against the monopolistic producers.

3. *Abolition of shares with disproportionate voting right*—The Companies Act provides that public limited companies can issue only two types of shares—preference and equity (ordinary). Companies have been prohibited from issuing deferred shares which used to concentrate control in the hands of a few persons. Further, a company is not allowed to devise any share that may attach voting right out of proportion to its value.

All these measures are commendable no doubt, but they would have been much more progressive by the grant of voting right to the preference shareholders. As a matter of fact, some States of the U.S.A. have extended this privilege to preference shareholders, particularly in the case of public utilities. In our country, this measure is further justified by the fact that preference shares are issued in denomination of Rs. 100, whereas ordinary shares are issued mostly in denomination of Rs. 10 only. It cannot be a case of discrimination against the ordinary shareholders, therefore, to permit one vote for each share of Rs. 10 in one case and Rs. 100 in another case.

4. *Cumulative voting*—Option has been given to public limited companies for adopting cumulative voting with regard to the election of directors. Where directors are appointed in accordance with cumulative voting, such appointments will be made at an interval of three years and interim vacancies will be filled by the board of directors. Under the prevailing voting method, namely one vote for each share, directors are perpetually elected by the majority group of shareholders, and the minority cannot elect even one director. The position becomes very inequitable in the case of larger companies with millions of rupees of investment.

The principles of cumulative voting can be explained in a better way by taking one simple illustration. A company has been organized with a share capital divided into 100 equal voting shares, and the shareholders are to elect seven directors. Any person, or group of persons holding 51 shares (majority) will elect all the seven directors for ever, whether a single resolution is required or seven separate resolutions are required for the election of directors. In contrast to this existing method, minority shareholders under the cumulative voting can elect some directors of their choice. Under this system, each shareholder controls as many votes as is equal to the number of voting shares he owns multiplied by the number of directors to be elected. Moreover, the votes need not be distributed over all the directors; a shareholder is at liberty to cast his vote in any way he likes it. According to our previous illustration, the majority group would control (51×7) 357 votes, and the minority group would control (49×7) 343 votes. If the majority group sets up 4 directors, it can elect directors by giving them each (357÷4) 89 votes. The remaining 3 directors would be elected by the minority through distribution of (343÷3) 114 votes per candidate. If the majority is greedy for a larger representation and the minority is well-organized,

a reverse situation may prevail. For example, if the majority spreads the votes over 5 directors who will get (357÷5) 71 votes each and the minority accumulates the votes in favour of 4 candidates by giving them each (343÷4) 85 votes, minority group will gain control over the board by electing 4 directors out of 7 directors in all.

5. *Investigations*—With a view to preventing mismanagement of the company and oppression to the minority, different types of investigations have been provided in the Act. An investigation may be initiated despite the passing of a special resolution for voluntary winding up or the making of an application to the court for relief against mismanagement. For making the investigation proceedings effective, the Inspectors have been vested with wide powers under the Companies (Amendment) Act, 1965.

Investigation may be initiated in the following five ways : (*i*) On the application from a required number of members as well as on the report from a Registrar of Companies, the Central Government may appoint Inspectors for the purpose of investigating the affairs of a company. (*ii*) When the company decides by a special resolution or the court orders in favour of an investigation, it becomes mandatory on the part of the Central Government to get the matter investigated by the appointment of Inspectors, (*iii*) Under certain circumstances, the Government may, on its own account, appoint Inspectors to investigate the affairs of a company. (*iv*) Special investigation has been provided to ascertain the persons who not representing the owners, may control the policy of a company from behind the scenes. That is, this special investigation is designed to prevent the existence of a community of interest in its different forms. (*v*) For speedy and effective check against unsound working of companies, the provision has been made for special audit by the appointment of special auditors and for searches or seizures of documents by Inspectors and Registrars.

6. *Other remedies against mismanagement and oppression*—The shareholders are entitled to obtain relief from the court in suitable cases. The court has powers (*a*) to regulate the conduct of company's affairs in future, (*b*) to give orders for the compulsory transference of shares of some members to other members, (*c*) to terminate or modify agreements with managing agents and others, (*d*) to set aside any transaction relating to property made within three months prior to application, and (*e*) to provide for any other matter deemed just and equitable including an alteration in, or addition to the Memorandum and Articles of the company.

The Central Government may also give relief to the shareholders (*a*) by appointing any two persons, whether members or not, as directors thereof for a period not exceeding three years on any one occasion, (*b*) by requiring the company to elect directors on the basis of proportional

representation, and by appointing not more than two persons as additional directors for the time being, and (*c*) by prohibiting any change in the existing board of directors without the approval of the Government, when a representation is made to that effect in the interest of the company.

Direct Restrictions on Management. Before going into the details of company management, it would be worthwhile to study briefly the general scheme of control introduced by the Companies Act, 1956.

1. *Government approval*—There are a number of sections in the Act under which approval of the Government is required for the working of a corporate enterprise. Approval of the Central Government is necessary for the appointment and reappointment of certain top-management personnel, for changes in the constitution of board of directors, for enhancement of the remuneration of top-management personnel and for the exercise of some of their powers.

2. *Number of offices*—The Act has consistently limited the number of companies with which a particular form of chief executives may be associated. The number of managing directorship and managership has been limited to two, and the number of directorship has been restricted to twenty.

3. *Independent board of directors*—The board of directors in the past failed to live up to its obligations, because it was overshadowed and duped by the managing agent. To make the board an independent and responsible body, certain positive duties and functions have been imposed upon the directors as well as some powers of the chief executives have been taken away to make them subordinate to the board of directors.

4. *Protection to auditors*—Auditors are said to be the representatives of owners of the company. But they could not discharge their duties faithfully in all cases for the tyranny of the managing directors. In cases where they were thrown out of their employment by the active management team for giving an unfavourable report, the shareholders were almost powerless to be of any help to them. In the new company law, the auditors' position has been made much more sound and independent, and they are not left at the complete mercy of the managing director. Further, they are required not only to state the position of companies in their 'true and fair view', but the genuineness of transactions, loans and advances is also to be indicated. In other words, the scope of audit has been extended greatly.

5. *Efficiency audit*—Companies pertaining to some classes of industries engaged in production, processing, manufacturing or mining activities are required to maintain proper records for utilization of material and labour. With a view to introducing efficiency audit in

such concerns, the Registrar or any authorised officer may inspect books, papers and vouchers of the company through surprise visits to them.

6. *Audit of cost accounts*—For companies engaged in production, processing, manufacturing or mining activities, the Central Government may direct for the conduct of audit of cost accounts by the appointment of separate auditors. Although the provisions relating to appointment, powers and duties of auditors for cost accounts are identical with regular auditors, they are to make reports to the Company Law Board.

7. *Overall managerial remuneration*—The remuneration payable to the top-management personnel as a whole has been limited to 11% of the net profit of the company along with a minimum provision of Rs. 50,000, in case of the absence or inadequacy of profit. The maximum share for each form of chief executives has again been fixed by the Act. Out of this 11% profit, directors may take 3% when there is no other chief executive and 1% when they are assisted by others. Managing directors may take 5% for one of them in the company and 10% for two or more than two managing directors in the company. The remuneration of managers as been limited to 5% of the net profit.

In case of very big companies having enormous profits, the total remuneration (excluding perquisites) payable to an individual managing or whole-time director or manager has been administratively restricted by the Company Law Board to an overall ceiling of Rs. 1.80 lakhs per annum when such remuneration is drawn from any one company and Rs. 2.70 lakhs per annum when it is drawn from more than one company. The definition of net profit has also been substantially altered in the Companies Act. For purposes of commission calculation, net profits mean such profits as are available after charging depreciation but before taking taxation and managerial remuneration into account.

8. *Tenure of office*—The tenure of office on the part of different top-management personnel has been limited to certain years. Directors are to retire at the end of three years. Managing directors and managers cannot be appointed for a period of more than five years at a time.

9. *Removal of managerial personnel on the basis of court's finding*—The Central Government may remove any person concerned in the conduct and management of company's affairs from the office on the recommendation of the court. The Central Government can make a reference to the court against any managerial personnel (*a*) when such persons are found guilty of fraud, misfeasance, persistent negligence or breach of trust, (*b*) when the company's business is not carried on according to sound business principles or prudent commercial practices, (*c*) when the company's operation causes injury or damage to the interest of others in the same line of business, and (*d*) when the company is

conducted with intent to defraud its creditors, members and others or in a manner prejudicial to public interest. On the findings of the court that the respondent is not a fit and proper person to hold the office of management, such persons can be removed from the office by the order of the Central Government. Moreover, the removed personnel are entitled neither to hold any office of management in any company during the next five years nor to receive any compensation for the loss or termination of office.

ORGANIZATION OF THE BOARD OF DIRECTORS

Directors as a group constitute the board which is the ultimate executive authority in the company. Because the powers vested in directors are to be exercised by them collectively as a board, they must take their decisions at board meetings. The board of directors may, however, delegate its powers to an executive committee of directors, to an individual director or to an outsider. Consequently, the organization of boards of directors differs from company to company. In a smaller company, the boards are usually organized to assume active supervision and management of the business. In other cases, they are loosely organized to hand over actual management to the managing director or to the other form of executives.

Requisite conditions for appointments. (*a*) In the case of public limited companies and all subsidiaries thereof, a person who is not a director retiring by rotation is required to express his intention of becoming a director to the company by giving a written notice of 14 days before the general meeting. On the receipt of such notice, the company is required to inform its members of the candidature for directorship by way of serving individual notices or making advertisements in two local newspapers before 7 days of the meeting. If appointed, such person cannot continue in the office unless his consent in writing to act as director is filed with the Registrar within thirty days of his appointment. Furthermore, every proposed director, other than the person who has given a prior notice of his candidature, has to file with the company a written consent to act as such director. Once appointed, all directors, except the technical or Government nominated directors, are to obtain qualification shares within two months of their appointment. The nominal value of qualification shares should not be less than five thousand rupees, and where the value of each share exceeds Rs. 5,000, the directors must hold at least one share. In all cases, the qualification shares are to be evidenced by share certificates, and not by share warrants.

(*b*) Certain persons are debarred from seeking appointment as directors, *viz.* (*i*) persons of unsound mind, (*ii*) undischarged in-

solvents, (*iii*) persons who have been convicted and imprisoned for at least 6 months during the preceding five years, (*iv*) defaulters of call money on shares, and (*v*) persons declared to be fraudulent by the court.

(*c*) A person who is already holding 20 directorships of public limited companies cannot be appointed as director of any other public companies limited by shares. A person, of course, can be director of any number of private limited and guarantee companies. Directorship in public limited companies has been restricted to twenty under a penalty of fine up to Rs. 5,000 for each company in excess of the first twenty. This provision aims at inducing the directors to take greater interests in the company's affairs by prohibiting them to divert their energies and attention.

Number of directors. The Companies Act has prescribed that every public limited company and its subsidiary must have at least three directors, and every private limited company and Section 43A public limited companies should have at least two directors. The Act has, thus, fixed the minimum number ; and the maximum number is usually determined by the Articles. But the maximum number of directors contained in any Articles after 21st July, 1951 cannot be increased by a public limited company and its subsidiary without the approval of the Central Government. The Companies (Amendment) Act 1965 permits the expansion of the board strength up to 12 members without Government approval. In between the maximum and minimum limits, the actual number may be varied by both the shareholders and the board of directors.

Members of the board. Except guarantee companies, every director of all public limited companies and their subsidiaries is to be appointed on the basis of a distinct and separate resolution. Members of the board fall into two categories : directors retiring by rotation and other directors. Directors retiring by rotation are elected by the shareholders at the annual general meeting by passing ordinary resolution and other directors are appointed by the debenture holders as well as by the Government in some cases. Besides, the board in its corporate capacity is empowered to appoint additional directors who can function up to the date of the next general meeting, to engage alternate directors in place of those directors who remain absent from the State for a period of three months or more, and to fill casual vacancies in the office of directors caused by death, physical incapacity or some other reasons. Unless the Articles provide otherwise, the subscribers to the Memorandum become directors till the first meeting of shareholders. Unless the Articles provide for the retirement of all directors at every annual

general meeting, the directors numbering at least two-thirds of the total strength are to be elected by shareholders as directors retiring by rotation.

Minority representation on the board. Option has been given to all public limited companies and their subsidiaries to provide in their Articles that the election of directors retiring by rotation may be held according to the principle of proportional representation based on the system of either cumulative voting or single transferable vote. Moreover, the Central Government is empowered to appoint two additional directors for the purpose of preventing oppression to the minority shareholders.

Tenure of office. In the case of a public limited company and its subsidiary, one-third of the directors retiring by rotation are to retire from office at every annual general meeting. All such directors get themselves retired within a period of 3 years, the rotation being regulated by the length of office of directors who retire by turn. Such directors can, however, seek re-election. The Amending Act of 1960 empowers public limited companies to provide in their Articles for the retirement of all directors at every annual general meeting.

Besides retirement, the tenure of office is determined by two other methods—removal and vacation. Shareholders may remove any director, other than a Government nominated director or a life director in a private limited company, by an ordinary resolution. But a resolution passed after a special notice is required for removing a director who has been appointed on the basis of proportional representation and for appointing another in his place. The objective of this provision is to prevent elimination of minority representation on the board.

A director should vacate office under the following circumstances : (*i*) failure to obtain qualification shares within two months, (*ii*) failure to pay call money on shares within six months, (*iii*) absence, without leave of the board, from three consecutive meetings or for a period of three months, whichever is longer, (*iv*) acceptance of any loan, guarantee or security for a loan from the company without the approval of the Central Government, (*v*) failure to disclose at the board meeting directors' interest in any contract or arrangement made with the company, (*vi*) lunacy, insolvency or application for the adjudication of insolvency as well as conviction for any offence resulting in a sentence of six months' imprisonment, (*vii*) order of the court restraining any fraudulent person to act as director, and (*viii*) termination of managing agency or any such office and other employment as caused the appointment of directors. For continuing their directorship in the company

even after such office requires to be vacated, the directors are liable to a recurring fine of Rs. 500 per day.

Remuneration of Directors. Directors, other than a managing director or a whole-time director, may be remunerated by way of a monthly payment with the approval of the Central Government or by way of commission on the net profits when the payment of commission is authorised by a special resolution of shareholders. The total outgo from the company on this account should not exceed one per cent of the net profit where there is any other management functionary and three per cent without any other management personnel. Moreover, the directors are entitled to fees up to Rs. 250 for attending each board meeting.

Meetings of the Board. The board has a fixed time of meeting which may be once a month or less frequently. According to the requirements of business, special meetings of the board may be called at any time. The company law requires at least one meeting in every three months and at least four such meetings in every year. Proper notice must be given to all directors. Decisions at board meetings are taken on the basis of majority vote. The quorum for directors' meetings consists of one-third of the total numbers, subject to a minimum of two directors. A director with a personal interest in the proceedings of the board cannot constitute the quorum for board meeting.

POWERS AND DUTIES OF DIRECTORS

Legal Position. Directors hold a key position in company management and control. The entire property of the company is placed in their hands, and they are to exercise trustee function in respect of that property. They are to make the best use of property by the adoption of suitable business plans and policies. In the process of running the business, they are not only concerned with the gainful employment of property, but they must also see that the property is duly conserved.

The nature of the company and the circumstances of its creation bestow upon the directors a pivotal position in corporate structure. To signify their position in the company set-up, the directors are described sometimes as agents and sometimes as trustees. But these expressions are not typical indication of their correct position. Legally, the directors are not the agents of company but its representatives. The company or its shareholders cannot take back the powers of management which are vested in the directors. It is the directors who alone are entitled to exercise these powers. But in the usual relationship created between a principal and his agent, the principal has always the right to usurp the powers of his agent. Secondly, unlike an agent who

is directly appointed, the directors require election to hold their position in the company. Lastly, the company itself is working through the medium of directors when they exercise any of its powers. Company, being an artificial person, requires some human hands for the conduct of its affairs. Directors impart that living and animating force to the artificial personality of a company. Accordingly, it can be said that the company does not delegate its powers to the directors so that they may be regarded as agents.

Again, the directors are not trustees for the shareholders or their company in the technical sense of the term. Company's property is not transferred to the directors as in the case of trustees. Property stands in the name of the company itself. But the directors occupy a position of trust and confidence with regard to the funds and assets of the company, and they have a fiduciary relation with the shareholders. They must act in good faith and with reasonable care and diligence. In managing the company, they must use that amount of prudence which an ordinary prudent man would take in his own case. If the directors act on the basis of their trustee position, they are relieved of any personal liability.

Statutory Powers. The Act has allocated the powers between the board of directors and the shareholders and has laid down the manner in which these powers are to be exercised by the board.

a. The two powers—to make calls on unpaid shares and to issue debentures—have been kept reserved for the directors who are to exercise the powers without their delegation by way of resolutions passed in board meetings.

b. There are three other powers which can be delegated to the managing director and others, and such powers are to be exercised by them within prescribed financial limits, viz. to borrow money otherwise than on debentures, to invest funds of the company, and to make loans.

c. Finally, there is another group of powers which cannot be exercised by the board without approval of the company in general meeting and accordingly they may be looked upon as *restrictions on directors' powers*. This group includes the powers (*a*) to sell, lease or dispose of the whole or substantially the whole of the undertaking, (*b*) to remit any debt or to extend the time for repayment of any debt due from a director, (*c*) to make investment otherwise than in trustee securities, (*d*) to borrow money in excess of the paid-up capital and free reserves of the company (temporary bank loans excluded), (*e*) to donate for charitable and other purposes any amount exceeding Rs. 25,000 or 5% of the average net profits based on previous three years, whichever is greater, and (*f*) to appoint any person as sole selling agent who is not

approved by the company in the first general meeting held after the date of the appointment of the selling agent.

Executive Powers. The board of directors exercises the following executive powers :

1. *Selection of officers*—The board appoints the officers of the company including the chairman, the secretary, the auditor and others. All persons of the middle management level are recruited by the board which determines their conditions of service and remuneration. The first auditor is required to be appointed within one month of the registration of the company. Moreover, the board appoints additional directors, casual directors and alternate directors of the company.

2. *Determination of policies and conduct of business*—The board of directors formulates the broad objectives and policies according to which business should be carried on by the salaried managers under the guidance of the chief executive. Where the company is actively managed by managing directors or others and where such personnel have been removed or have vacated office, the board of directors is required to fill the vacuum by assuming the task of active management until fresh arrangements are made.

3. *Declaration of dividend*—The board of directors is the final authority in respect of dividend distribution to shareholders. Even though all the shareholders might agree to distribute profits as dividends, they could not legally do so without the approval of the board. The board of directors authorises distribution of profits after taking several factors into consideration, such as (*i*) provision for depreciation, (*ii*) provision for other contingencies, (*iii*) creation of reserves, (*iv*) future financial commitments and (*v*) sufficient cash balance.

4. *Issue of additional securities*—Since the company needs additional funds from time to time, it may bring out further issues of shares or debentures for meeting the financial requirements of the company. Although the issue of new securities is authorised by the company in general meeting, it is the board which decides upon the time, the amount and the terms of issue. The Companies Act requires that new issues are to be offered to the existing shareholders *pro rata*.

5. *Other accessory powers*—They are to delegate adequate managerial authority, to make contracts and agreements in the name of the company, to appraise the progress of the company, and to do other acts which become necessary for the conduct of a business enterprise.

Duties of Directors. The Companies Act has imposed upon directors several duties which may be stated as follows :

a. *Loans to directors prohibited without approval*—Without the sanction of the Central Government, a company cannot make a loan

or give a guarantee or provide any security for a loan to any of its directors, whether directly or indirectly through a firm or company in which the directors have financial interests. This provision, however, does not apply to banking companies, private limited companies, or holding companies.

b. Contracts involving directors' personal interest are voidable without the board's sanction—Directors including the firm or the private company with which any director is associated, should not enter into contracts with the company in regard to (*i*) sale and purchase of goods or services, (*ii*) underwriting of securities of the company without the prior consent of the board of directors. If the consent of the board is not obtained within three months from the date of contracts, such contracts can be set aside at the option of the board.

Sale and purchase of goods or services do not require board's sanction in those cases where the transactions are made for cash at the prevailing market prices, where the contracts arise from regular trading or business activities and do not involve a cost exceeding Rs. 5,000 in the aggregate for any year during the contract period, or where banking and insurance companies make transactions with their directors in the ordinary course of business.

c. Disclosure of directors' interest at board meeting—Every director is required to disclose the nature of his concern or interest in any contract or arrangement entered into by the company at the earliest possible time before the board meeting. Omission to make this disclosure results in punishment by way of fine. Unless the extent of directors' interest in any other company exceeds 2% of its paid-up share capital, such other company can enter into contracts freely with the company concerned and directors thereof are not required to disclose their interest at the board meeting.

With a view to ensuring this disclosure, the Act provides that every public limited company should maintain a separate register showing therein particulars of contracts in which directors and their relatives are interested, and also the particulars of firms and companies with which the directors are associated as partners, members or directors.

d. Disclosure to shareholders when a director is interested in the appointment of managing director and others—If a director is interested in the appointment of top-management personnel as well as in the variation of terms of their existing appointment, the company in that case is required within a period of 21 days to circulate among its members the matter stating therein the conditions of appointment and the interests of directors.

Directors must make this disclosure to enable the company to maintain a register containing names, addresses and other particulars of directors, managing directors and other top-management personnel of the company. Extracts from this register are required to be filed with the Registrar within thirty days of their appointment. This register is open to members for inspection.

e. Disclosure of directors' shareholding and register thereof—It is the duty of directors and persons deemed to be directors (i.e. the persons in accordance with whose instruction or direction the directors are accustomed to act) to make a full disclosure of the value and number of their shareholdings.

Another book that is required to be kept by all public limited companies is the "Register of Directors' Shareholding" which should contain particulars of securities held not only in the company of which they are directors, but also in other allied companies. For the purpose of preventing speculation in shares, it has been provided that price of securities along with other details of the transaction should be recorded in this register when new share transactions are made by the present directors. This register is also open to members for inspection, and the Registrar may at any time require a company to submit an extract from this register. The Companies (Amendment) Act, 1960 requires that shareholdings by top-management personnel are also to be recorded in this register.

f. Assignment of office prohibited—A director cannot transfer the duties and responsibilities associated with his position of directorship to any person. That is, assignment of office is absolutely prohibited under the Act.

g. Maintenance of a place of profit prohibited without approval by special resolution—Except with the approval of shareholders given by a special resolution, no director can hold directly or indirectly any office or place of profit under the company or under any of its subsidiaries.

Liabilities of Directors. The Memorandum of a limited company may provide for an unlimited liability of the directors who, in that case, should be acquainted with the fact of unlimited liability before their appointment. The Memorandum may also be altered so as to make the liability of any director, manager or managing director unlimited.

Directors may become liable to the company and its shareholders as well as to the outsiders. This liability in turn may arise from a civil suit or a criminal suit for certain omissions and commissions under the Companies Act, 1956. The Act contains too many sections to list under which the directors are liable directly or by implication as officers of

the company. For the sake of simplicity, we may study the grounds under which the directors are held liable.

1. *For losses due to negligence*—Directors may be held responsible for losses sustained by the company because of their failure to use reasonable care and intelligence in the conduct of business. If they have used reasonable skill and diligence that can be expected from the persons of their status, knowledge and experience, they are free from this liability, although the company has suffered losses due to the poor judgment of directors.

2. *For losses due to misfeasance*—Misfeasance has been defined as "any breach of duty in the conduct of the company's affairs which causes loss to the company." As the principal executive authority in the company, the directors occupy an unenviable position in the observance of various duties. They are responsible for all happenings in the company. Duties of running the business within the bounds of the company law fall primarily upon the directors. As a result, the directors are exposed to liability for breach of any and every duty.

3. *For breach of trust*—Because of their fiduciary relationship with the company and its shareholders, they tend to become liable for any loss that may arise from breach of trust. Directors must not make any personal gain or secret profit at the cost of the company. Moreover, the use of company's property for personal purposes may amount to a waste of assets, and the company may require the directors to make good the loss.

4. *For ultra vires acts*—Directors are not supposed to go beyond the powers which are granted by the Articles of the company. They become personally liable for the amount spent through the exercise of all such excess powers. Moreover, the directors may be held liable for doing certain acts that are earmarked for the shareholders.

5. *For false statements and fraudulent acts*—A director becomes liable for his false and misleading statements as well as for his fraudulent and illegal acts to any person, whether within or without the company, who suffers loss through the reliance upon these statements and acts.

CRITICAL STUDY OF THE BOARD

Character of the Board. The powers given to the directors are to be exercised by them as a group, and individual directors are incompetent to exercise the powers conferred upon the board. Because of this legal requirement, the board becomes a special form of committee. Committees are organized with two different capacities. Some committees are created for discharging advisory functions in an organization, while other committees are formed for undertaking executive or command authority in an enterprise. The board assumes executive

authority in all companies. For this reason, the board becomes what is known as "plural executive". As opposed to an individual or single executive, the powers of company management are exercised by this joint or plural executive. But the universal experience is that a plural executive becomes totally unfit for assuming details of management functions in day-to-day affairs. As a result, the board delegates its powers of management to a management team under the leadership of the chief executive. The Companies Act permits several types of chief executives for the everyday operation of companies in our country. At present, the permissible forms of chief executives are (*a*) the executive committee of directors, (*b*) the managing directors, and (*c*) the general managers.

Role of the Board. When the board delegates its authority and duty of company management to the chief executive, the question naturally arises as to what the board does. Is the compliance with statutory requirements its only task left? To say the least, compliance with statutory requirements is a secondary task, not the principal one. As the head of a business enterprise, the primary concern of the board is to look for higher accomplishments and better performances on the part of the company. The board is rather compelled to devote its energy and time for meeting the needs of the company law. If the board could have been relieved of such legal bindings, it would have paid greater attention on business activities.

The board is the delegator of authority to the chief executive. As delegation does not mean abdication or abandonment of managerial authority and duty, the board cannot free itself from the ultimate duties of company management. The board has to give an account of its performances to the owners of the company. For enabling the board to give an account of its own performance, the board of directors demands an accountability from the chief executive who remains busy with day-to-day operations of the company. But there is a lot of difference between the accountability of the board to the shareholders and the accountability of the chief executive to the board. The company is owned by the shareholders, while the assets of the company are owned not by the shareholders but by the company itself. This separation between the ownership of the company and the ownership of company's property has made the board somewhat independent of the shareholders. The board is given a "trustee role" in husbanding the corporate assets for the benefits of the company, and for that matter, for the benefits of its owners. For the conservation of company property, the board can go in some cases against the wishes of all shareholders. For example, the dividend distribution can be withheld by the board at its discretion.

Effectiveness of the Board. As an executive body, the board is very badly designed and has some inherent weaknesses. The requirement of joint responsibility and joint decision making has made the board in many cases irresponsible in character and indecisive in action. Having a corporate capacity and responsibility, the board has neither "a body to be kicked nor a soul to be damned." These weaknesses of the board have made the chief executive in some cases more powerful than the board in matters of company management. The board has been reduced to a shadow king or a figurehead ; and the chief executive has become all-powerful by dethroning the board from its exalted position.

The effectiveness of a board of directors is dependent upon several aspects of its organization. From the experiences of companies in other countries of the world, some vital aspects contributing to the success of the board may be stated as follows :

a. *Size of the board*—The size of the board should neither be too large nor too small. Too large a board fails to be an organ of action and turns out to be a debating body. In contrast, too small a board cannot give representation to various points of view and does not secure the necessary breadth of knowledge and experience for purposes of proper guidance and direction. The size of the board is to be fixed at such a number, say from five to twelve, as it becomes conducive to the successful working of the enterprise.

b. *Membership of the board*—The success of the board lies in the selection of appropriate members and a capable chairman of the board. *First,* membership of the board should be wide enough to give representations to varied social and business interests. As regards business interests, unless some of the members are well acquainted with the basic functions (*e.g.* sales and production) of the company's business, an effective guidance or control is not practicable on the part of the board. For the satisfaction of social interests, there should be some members who can represent the views of three vitally interested parties in any business, *viz.* the consumers, the employees and the owners. *Secondly,* the age structure of the board members is to be balanced by the inclusion of both young and old directors. If all the directors of a board are about the age of 65 years or more, the board becomes a body of olds and invalids with conservative outlook and inactive frame of mind. There must be some young directors who can set the way towards initiative, vigour and drive. *Thirdly,* the board is required to demand an accountability from the chief executive, whether in the form of managing directors or others. Accordingly, unless the members are free from the hypnotic or controlling influence of the chief executive, the board cannot demand a strict account of the performance of its own delegatees, *viz.,* the managing directors and others. The chief

executive controls the board members in those cases where the directors, in addition to their directorial position, accept some full-time jobs in the company under the overall control of the chief executive. That is, the board should not be packed with inside directors alone ; there must be some outsiders who can put discerning questions to the chief executive. *Finally,* chairmanship of the board is a key position for successful committee operation. It is the competent chairman who can procure the collective thought and judgment of members within a shorter period by his inspiring leadership and able direction.

c. *Informing the board*—The inclusion of outsiders on the board requires a programme for keeping the directors regularly informed about the actual performance and proposed actions of the company. The board meeting being short in duration, the directors cannot give considered opinions and valuable suggestions regarding the company's affairs unless adequate information is supplied to them beforehand.

CHAPTER 7

COMPANY MANAGEMENT AND THE CHIEF EXECUTIVE

FORMS OF THE CHIEF EXECUTIVE

The board, being unsuitable for undertaking actual command authority over the day-to-day operation of the company, requires a chief executive to assist it in managing the business. The chief executive is to act under the overall control, direction and supervision of the board, since the board is the delegator of authority and duty to the chief executive. Because of this delegation, the board controls the activities of the chief executive by way of (*a*) determining basic objectives and policies of the company, (*b*) approving budgets and future programmes, (*c*) evaluating past activities, and (*d*) counselling with the chief executive and his subordinates through asking questions and giving suggestions.

The Companies Act as amended in 1969 has prescribed several patterns of company management based upon the following forms of chief executive :

1. The executive committee of directors
2. The managing director
3. The general manager

Out of the three forms of the chief executive, a company can appoint at present only one form of the chief executive. Previously, the system of managing agents was very popular and significant in character. During the year 1954-55, 40.7 per cent of public limited companies having 66.3 per cent of their total paid-up capital were managed by managing agencies.[1] In subsequent years, the company coverage of managing agencies was found to be steadily reduced. The total number of managing agencies on March 31, 1967 was 479 comprising 235 unincorporated concerns, 185 private limited companies and 59 public limited companies. Out of 479 managing agencies, as many as 394 agencies managed one company each, 35 agencies two companies each and the remaining 50 agencies managed more than two companies each. The total number of managed companies was 720 with a paid-up capital of Rs. 496.6 crores.[2] In December 1967, the Government

[1] Nigam, Raj K., *Managing Agencies in India—First Round : Basic Facts.*

[2] *Eleventh Annual Report on the Working and Administration of the Companies Act 1956.*

decided to abolish the managing agency system altogether along with the institution of Secretaries and Treasurers with effect from April 3, 1970. To give effect to this decision, the Companies Act was amended in 1969. Even before the complete abolition of the managing agency, its declining importance was witnessed in the management patterns of Indian companies.

EXECUTIVE COMMITTEE OF DIRECTORS

An executive committee is formed by some of the board members for assuming the task of actual management of the company in its everyday affairs. In some cases, of course, the full board remains engaged in such management work, and no chief executive positions are created in the company organization. But where the full board does not assume the task of actual management, and a small committee of select directors is entrusted with the powers of company management, that small committee becomes the chief executive through the delegation of powers from the full board of directors. As the members of the executive committee are whole-time directors, the provisions of the Companies Act relating to managing directors apply equally in their case.

This executive committee becomes a miniature board within the overall control of the larger board. Like the board of directors, joint responsibility and joint decisions are the distinguishing marks of this form of chief executive. Joint responsibility without the allocation of individual responsibility encourages irresponsibility on the part of members of a committee or board, whether such body is large or small. Moreover, joint decision making is a time-consuming process and leads frequently to indecisive actions. As the board being a plural executive cannot become successful in actual management work, the executive committee too fails on the same ground of joint responsibility and joint decision making. Unless this type of chief executive is reorganized on a team basis with the allocation of individual responsibilities and of separate powers of decision making, no effective work can be done by this executive committee. As opposed to the executive committee, the executive team provides the best choice for large-sized companies.

The model of such executive team can be found in a playing football team. All the eleven members of a football team have assigned positions and individual spheres of activities, but they are united in their common purpose of sending the ball towards the opposite party's net as well as of defending their goal area. Still, goal keeping is the fixed responsibility of one player in the role of goal-keeper. Thus, individual responsibility and commonness of purpose are perfectly matched in the

playing team. Likewise, the executive team is best organized by allocating individual responsibilities in distinct spheres of activities and by securing commonness of purpose through the provision of joint discussions but of individual decisions.

MANAGING DIRECTORS (*Or Whole-time Directors*)

The absence of any special provision in the old Act with regard to the Managing Director was utilized by some unscrupulous managing agents and directors to serve their own purposes. When the amending Act of 1936 placed severe restrictions upon managing agents, some of them got themselves established as managing directors so as to come out of the pale of regulations. In other cases, some influential members of the board of directors without being appointed as managing directors monopolized the powers of the board to carry out their dishonest designs. For these reasons, the new company law has tightened its measures for the appointment of managing directors.

Appointment—A managing director is defined as "a director who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its board of directors or by virtue of its Memorandum or Articles of Association, is entrusted with substantial powers of management which would not otherwise be exercisable by him, and includes a director occupying the position of a managing director, by whatever name called." The Act places the following restrictions on the appointment of a managing director.

1. A company is not permitted to appoint any person as its managing director or whole-time director who is an undischarged insolvent, and who at any time (*a*) has been adjudged insolvent, (*b*) has suspended payment to his creditors or has made a composition with them, and (*c*) has been convicted of a non-bailable offence.
2. All appointments or reappointments of managing directors for the first time after the commencement of the Amending Act of 1960 require the approval of the Central Government. Every public limited company and its subsidiary should obtain this approval within three months of its incorporation.
3. Alterations of the Articles cannot be made in regard to managing directors so as to change their terms of appointment and re-appointments without the approval of the Central Government.
4. All appointments of managing directors should be made by a resolution passed with the consent of all the directors present at board meeting. Individuals alone can be appointed as managing directors, not a firm or a body corporate.

Number of managing directorships—The number of managing directorships has been limited to two only. A person holding more than one office of managing director or of manager in any limited company, whether public or private, cannot be appointed as the managing director of a public limited company or its subsidiary. Under the Companies (Amendment) Act, 1960, a person associated as managing director or manager of more than two companies, of which each one or at least one is a public limited company or a subsidiary thereof shall have to choose two companies in which he may like to continue his managing directorship or managership within one year of the commencement of the Amending Act. In deserving cases, the Central Government may allow a person to be the managing director of more than two companies.

Tenure of office—The period of appointment should not exceed five years at a time. Although managing directors are eligible for reappointment, yet no decision regarding reappointment can be taken earlier than the last two years of their tenure. This provision does not apply in the case of private limited companies.

Remuneration—Managing directors may be remunerated at a percentage of net profit. But such percentage should not exceed five where there is only one managing director and ten in the aggregate where there are more than one managing director. When the remuneration is based upon a percentage of net profits, managing directors should not obtain any other remuneration from the subsidiary company. Managing or whole-time directors may also be remunerated by way of a monthly payment or at a specified percentage of the net profits of company or partly by one way and partly by the other. The remuneration clause of the Articles cannot be changed without Government approval. Compensation for loss of office can be claimed by managing directors in appropriate cases, but the amount of compensation should be equivalent to remuneration payable for the unexpired period of office subject to a maximum of 3 years.

THE OLD SYSTEM OF MANAGING AGENTS

Origin and Importance. The industrial development of India owed its origin and growth much to the managing agents who provided an unrivalled system of company management in the industrial history of the world. This unique system of management appeared in India from the ruins of the prevailing British agency houses towards the middle of the nineteenth century, and in course of time, it came to be recognized as the universal and common pattern of company management in our country. Calcutta is regarded as the seed-bed of this institution, the seedlings of which were transplanted in different parts

of the country. Originally developed by the European firms, it was later copied by the Indian firms also, the primary reason for its adoption being the facility of concentrating capital and managerial ability in a few persons. The Company Law Committee has nicely summed up its origin and character by saying that "history, geography and economics all combined to create and develop a system which, in some of its distinctive features, still retains its unique character."

The system came into prominence because of the fact that it assumed the entire task of setting up and running industrial enterprises so as to deliver goods to the common people in the virgin soil of India. The managing agents had to overcome insurmountable difficulties in their every step of the task, and they were compelled by circumstances to do the work unaided. With no promoters, financiers and managers available in India at that time, they had to discharge singularly the responsibilities of all. Managing agents, in their beginnings, associated themselves deeply with the industrial concerns under their care and left no stone unturned to make their enterprises fruitful. It was really an achievement of the system that industrial enterprises floated by managing agents acquired an enduring success which in turn paved the way for further industrial progress. Briefly, many of our industries could not have yet seen the light of the day but for the uncommon zeal and untiring efforts on the part of managing agents. It was thus natural for the managing agents to dominate the earlier enterprises which were their handiwork.

With the progress of time and knowledge, however, the system outlived its existence, and much heat of argument was raised against the usefulness of the system. Despite a heavily set public opinion and a sceptical general outlook against the system, the country could not bid a farewell to it before April 1970. The system became so deepened and widened through extensive ramifications over the industrial structure of our country that we were forced to tolerate the system over a long period. Before giving the system a parting kick, the managing agency system was chained heavily by the company law with the object of purging it of the evils.

Achievements of Managing Agents. Managing agents came to the forefront of industrial organization through their activities in the triple role of promoters, financiers and managers. Accordingly, it would be helpful for our understanding to study the activities of managing agents under the following three heads.

Promotion—As the usual work of promotion involves four distinct steps, managing agents discovered business opportunities, made necessary investigations about the prospects of success, assembled the business proposition, and finally procured funds for converting the proposition

into a matter of practical reality. In this way they brought into existence a good many industrial enterprises in India. The Fiscal Commission of 1949-50 held that "In the early days of industrialization, when neither enterprise nor capital was plentiful, the managing agents provided both, and India's well-established industries like cotton, jute, steel, etc. owe their present position to the pioneering zeal and fostering care of several well-known managing agency houses". They were the pioneers and torch-bearers in the industrialization of the country ; and they were practically the only class of promoters in the nineteenth century. It is agreed by all that managing agents admirably discharged their responsibilities of promotion up to the first-quarter of the present century.

Gradually but steadily, managing agents were ousted from the field of promotion by a new class of promoters, and their position in respect of promotion was relegated to one of much lower-ranking importance. The emergence of a distinct class of promoters it to be witnessed in many new industries like sugar, paper, chemical, etc. The reduced importance of managing agents became crystal clear by the recent figures of company formation. Managing agents were too busy and preoccupied with their large number of concerns to find any extra time for setting up new enterprises. Whatever might be the reason for it, managing agents could not be expected to do the job any further.

Financing—In the beginning of their careers, the managing agents were required to unfasten the financial knot. There were no investing public and organized capital market in India at that time. Managing agents made all possible attempts to collect funds from within and outside the country. Personal resources and surplus funds of their friends and relatives were utilized in business, on the one hand, and the British managing agents attracted foreign capital in India, on the other. The initial capital of the enterprises was invariably supplied from these direct means. Apart from these direct methods, several other sources were tapped for consistent feeding of the enterprises with requisite finance. They raised bank loans and gathered public deposits to be employed either as fixed capital or as working capital. There are cases on record where they saved many concerns from utter collapse through the extension of adequate financial support. In this way, they nursed the industrial enterprises with financial feeding and nourished their growth during adversities with suitable financial tonic.

In the role of financier too, the latest position of managing agents was proved to be of little significance. In the past, they used to purchase a substantial block of shares and debentures in their promoted companies. But with the growth of investment market, industrial concerns were divested of the funds of managing agents. The extent of financial interest of the managing agents in their managed companies used to vary from case to case, and it could not be generalized in a

particular way. However, one sweeping remark was applicable to all cases; managing agents in the recent past used to hold the minimum possible securities to retain their control over the enterprises, Moreover managing agents did not deserve any credit for the raising of bank loans and public deposits in the altered situations of the country. It was recently estimated in official circles that managing agents provided their managed companies with about one-eighth of their fixed capital.

Management—European managing agents introduced the methods of modern management in our industrial enterprises, and our industrial concerns were continuously provided with trained and efficient managers by them. Different managing agency houses acted as training grounds for the acquisition of the management skill, and a large number of persons were trained into the techniques of management. Large-scale industrial organizations could not have progressed much without the development of these management methods. Moreover, the benefits of industrial co-operation and industrial combination were secured by managing agents for their common group of managed companies. Thus, it is acceptable beyond doubt that the requisite technical and managerial know-how of the managing agents resulted in the establishment of sound and efficient management in the enterprises.

But this creditable service was undermined by the irregularities and malpractices which appeared in the system. It is this aspect of their work that invited the bitterest public criticism. Indian managing agents were made the targets of greater attacks on this score because of their narrow, conservative and selfish outlook. Unlike their Indian counterparts which were mostly hereditary and sectarian in character, the European agency houses maintained their tradition of sound management to a marked degree by the introduction of outside talent and skill.

Failures of Managing Agents. The failures and evils which disreputed the system of managing agents may be stated as follows:

1. *Company overlords*—Managing agents became the all-powerful body in the control of companies. The board of directors is supposed to be the primary executive authority which delegates its powers of management to managing agents. In the companies managed by managing agents, the relationship between the directors and the managing agent was otherwise. Since the directors were placed in power mostly by managing agents, they became mere puppets in the hands of managing agents who were the real lords of their managed companies.

To gain permanent control over their managed companies, various devices were adopted by managing agents. Being the promoters of their managed companies, they became the first directors who in turn appointed the managing agent with dictating terms and conditions of their own. This unholy alliance

of promoters, directors and managing agents acted as the cobweb of all troubles. Opportunities were not lost to take advantage of the corporate form in its separation of ownership from control, particularly where the shareholders were scattered very widely. Previously, they could concentrate their control through the holding of some key deferred shares. In other cases, managed companies were deliberately under-capitalized in order to tie thm up under the feet of managing agents on financial grounds. As a result of all these methods, companies were managed like proprietary concerns in the past.

2. *Excessive remuneration*—The total outgo from the company on account of remuneration consisted of some regular and irregular items, *viz.* (*a*) office allowance, (*b*) commission on profits or sales, (*c*) compensation for loss of office, and (*d*) various special charges for buying materials, selling goods, rendering other services and giving guarantee for bank credit.

(*a*) In Bombay and Ahmedabad, managing agents were paid a fixed sum as office allowance, the amount of which usually varied from Rs. 6,000 to Rs. 50,000 per annum. In Calcutta, however, a separate office allowance, over the actual expenses incurred to maintain the requisite staff, was not charged. An extra office allowance over the legitimate expenses became a form of exploitation. (*b*) Second item of remuneration was common to all managing agents. But according to the bases of commission calculation, different amounts were drawn from the same trading results. In the early days, commission on production was the common rule. But since it led to over-production as well as to production of bad quality goods, this method was abandoned towards the end of the nineteenth century. Commission either on sales or on profits was adopted in its place. Commission on sales was also defective, because it encouraged unprofitable sales or sales on credit with consequent bad debts. Commission on profit was the best method of the three alternatives. The amending Act of 1936 provided that remuneration was to be based in all cases as a percentage of net profit together with an office allowance. Any other form of remuneration had to be sanctioned by a special resolution. (*c*) The third item of remuneration was made up of a sum of compensation for loss of their offices. The amount of compensation was stipulated in their agreements as a fixed sum ranging from 5 to 7 years' commission and it was payable in all cases for termination of agreements. (*d*) Besides these, the managing agents used to take extra commission as buying agents on the purchase of raw materials and fixed assets, and as selling agents, on the sale of finished goods. There were endless opportunities to take these commissions on two or three counts through the transference of goods from one company to another. In other cases, unnecessary specialist services were arranged for their managed companies to drain off money.

According to the Memorandum of the Bombay Shareholders' Association which examined the average remuneration of managing agents based on a period of 8 years (1940-47), the aggregate remuneration

came to 38.8% of net profits in Bombay and 36.9% of net profits in Calcutta when the commission was based on net profit. It came to 70.5% of the net profits in Ahmedabad and 54.2% of net profits in Calcutta when the commission was based on sales.

3. *Inter-company investments*—The inter-company investment of funds among the companies under the same managing agents was a common practice. Surplus funds of one company were utilized in giving loans to other companies or in purchasing shares or debentures of the companies under the same managing agents. This practice had several drawbacks. (*a*) When the investment was made in the form of a loan, shareholders of the lending companies were deprived of any return on their investments. (*b*) The funds were not easily realizable when investments were made in the form of company's shares. (*c*) The practice of inter-company investments often led to the continuance of insolvent concerns which should have been closed down in the wider interests of the industry. (*d*) Managing agents indulged in what is known as 'trading on the equity' through this inter-company investment of funds. (*e*) Moreover, it also spelled ruin to the sound concerns whose funds were dissipated.

4. *Loans to managing agents*—Another abuse of the system was the practice of taking large advances from the managed companies. These forced advances as a matter of fact were responsible for infinite troubles on the part of the lending companies, because these loans were taken without having any regard for the interests of managed companies.

5. *Misuse of inside information*—This evil is deeply associated wtih the company organisation, and it is widely practised by top-management personnel in all countries of the world and it can never be removed by legislation. The evil was only accentuated in the case of the managing agency system which offered endless opportunities to the managing agent to make inside manipulations in various ways. It encouraged speculation in shares. Share speculation was facilitated in the case of managing agents because of two special factors, viz. they could vary the prices of shares through manipulating the rates of dividend, and they had ample cash resources of several companies at their disposal.

6. *Assignment of office*—The assignment of functions and interests was another abuse that had cropped up into the system. Before the amending Act of 1936, this assignment could have been made without the sanction of the board of directors. After 1936, the assignment was made practicable with the approval of the company in general meeting. But this provision was defeated by the transference of shares in the stock market. During the war period, there was serious trafficking in managing agency rights, and the Government was compelled to pass an emergency statute in 1951 to prevent this transference of control. This

assignment of office appeared highly objectionable because it was a change in control of the enterprise from the hands of industrialists into the hands of financiers and speculators. Industrial concerns came to be guided mostly by financial considerations. Finance instead of being the servant of industry became the master of it.

7. *Concentration of control*—Previously, they could have controlled any number of companies, and thereby the system was responsible for undue concentration of wealth and power in a few hands to the detriment of public interest. Because of this concentration, the system was responsible for the growth of vested interests in the country and for the exploitation of the ordinary investors. That is, managing agents encompassed so many activities and controlled so vast a national wealth that they appeared as a serious menace to the society and as a potent killer of the economic progress of the country.

8. *Other vices*—The system became a device which opened the floodgates of irregularities, abuses and malpractices. (*a*) The hereditary character of Indian managing agents made the system very inefficient owing to the proverbial incompetence of heirs. (*b*) Managing agents were managing so many concerns as could not be managed efficiently. It resulted in degenerating the system and in introducing irresponsible control of the enterprises. (*c*) Appointment of friends and relatives to the key managerial position brought out a situation which was responsible for the sacrifice of skill and efficiency to nepotism. As a result, the system lost its original significance.

Reasons for the Abolition of the System. No doubt managing agents rendered a yeoman's service for the development of industries in our country, and practically every important industry was established and expanded by them. But whatever glorious part might have been played by managing agents in the past, the abolition of the system became long overdue. A close analysis of their recent deeds and misdeeds would clearly reveal that the system overlived its existence. It had its origin and growth in the past, and a clear trend of decay and stagnation was perceptible in the system from the 1920's.

Managing agents could not claim their continued existence on the ground of past achievements alone. There were no remnants of former glory of the system for justifying its existence in the years to come. Bereft of any worthwhile services, the system proved to be an economic slur on the country. Valuable services and good performances of a few managing agency houses did not go to the credit of this system, rather such credit was due to the individual industrialists. On the active participation of the State in the growth of industries and on the widespread foreign collaboration in providing technical and managerial knowledge at the present time, the usefulness of the system became a matter of past

history. Moreover, the adoption of the socialist pattern of society as an objective of economic policy also militated against its continuance.

In the role of promoters, the managing agents were outdistanced by miles at the present time. A token number of concerns that were promoted by them could not make the system by any stretch of imagination an indispensable one. When a large number of industrial enterprises came into existence without their help, the future industrial promotion and development would be least affected after the exit of the managing agents.

As regards financing activities, the managing agents no longer provided industrial finance to an overwhelming extent that they used to do in the past. Their financial contribution was reduced in most cases to an insignificant amount. It would be more correct to say that financial needs of modern large-sized enterprises were beyond the means of managing agents. The inadequacy of funds became a serious problem in those cases where all the managed companies under a particular managing agent required funds simultaneously. Managing agents over the past few decades were increasingly relying upon the investing public and capital market to supplement their meagre personal resources for maintaining and extending the industrial empire. Capital market in recent years developed in quantitative as well as in qualitative terms, and the required industrial finance was raised from the market without the interposition of managing agents. The State has also assumed an active role in the provision of industrial finance through the setting up of a number of finance and development institutions which are expected to close the financial gap as well as to fill the industrial vacuum created by the removal of managing agents. Moreover, managing agents had no influence nowadays upon the raising of bank loans and public deposits, particularly after the nationalization of 14 commercial banks. Funds were supplied equally to all industrial concerns. Even if there were managing agents, guarantee or credit of the managing agent was not required when proper security was furnished. It was contended by some that in case of discontinuance of the system, the funds of the managing agents would be lost to industrial enterprises. After the burial of the system, the funds of the managing agents would not be locked up in iron safes or hoarded underground ; but it would be invested in some form or another. Whatever might be the nature of investments, *e.g.*, bank deposits, shares and Government papers, the funds of the managing agents would come back to industrial enterprises.

In the sphere of management, the managing agents were supposed to have a close preserve of management methods and principles, and it was thought that business talent and skill would be lost along with the discontinuance of the system. Circumstances have changed today from what they were in the nineteenth century. Management has grown up

as a profession in the twentieth century, and a large number of institutions have been established within and outside the country for imparting necessary trainings in management. In the developed countries of the world, these trained managers are being placed in high executive positions. The hackneyed knowledge of most managing agents stand no comparison with the ability and skill acquired by the trained managers. It would be no exaggeration to say that, in their management competency, most of the managing agents were not really managers but pseudo-managers. But unfortunately we were required to pay a fabulous price for their so-called management ability.

As against these doubtful services of the managing agents, their disservices engulfed the country and polluted business ethics. Pointed reference was made by Prof. K. T. Shah in his comments, "the system is rotten, root and branch, leaf and bark and blossom". The opponents of the system once demanded in Parliament that "the managing agency system must go lock, stock and barrel". The system in itself had no magic or mystic power to create wonders in the business world.

Although our analysis calls for the total abolition of the system, it was not ended earlier than April 1970, and in the meantime, an attempt was made for mending the system before ending it. As the reform of the system proved infructuous, the Central Government decided in September 1966, on the recommendations of the Managing Agency Enquiry Committee under the chairmanship of Mr. I. G. Patel, to discontinue the managing agency system in cotton textile, jute textile, cement, sugar and paper and pulp industries within a period of three years from 2nd April 1967. A further decision was taken by the Government in December 1967 to abolish the system altogether in respect of other industries from a future date. To give effect to this decision, the Companies (Amendment) Act, 1969 provides for the complete abolition of the system from April 3, 1970. The system of Secretaries and Treasurers was also terminated from the same date.

MANAGERS

Companies may also appoint the 'Manager' who, subject to the superintendence, control and direction of the board of directors, has the management of the whole or substantially the whole of the affairs of the companies. Only an individual can become a manager who must not be any body corporate, firm or association. Except two provisions, *viz.* appointment of individuals and disqualification for managership which apply to both public limited and private limited companies, all other provisions relating to managers apply only to public limited companies and their subsidiaries.

No individual may at the same time be the manager of two com-

panies unless sanctioned by a unanimous resolution of the board. The Central Government may allow a person to be the manager of more than two companies in appropriate cases.

Individuals who are disqualified for being appointed in the position of a manager include an undischarged insolvent and the person who, at any time within the preceding five years, has been adjudged insolvent, has suspended payment to his creditors or has made a composition with them, or has been convicted of an offence involving moral turpitude (non-bailable offence). The Central Government may, however, remove these disqualifications.

The manager can be appointed for five years at a time. He may be remunerated either by a monthly payment or by a percentage of net profits not exceeding five. In the absence or inadequacy of profits, he may be paid a minimum remuneration. Without the sanction of the Central Government, the remuneration of the manager cannot be increased over five per cent of net profits. Assignment of office by a manager is strictly prohibited.

CHAPTER 8

SECRETARIAL PRACTICE AND COMPANY PROCEDURES

THE COMPANY SECRETARY

The secretary of a company is its permanent officer to guide the clerical work of the company. He is only a servant of the company like other employees, subject to the direction and control of the board. As Lord Esher has observed, "The secretary is a mere servant; his position is that he is to do what is told and no person can assume that he has any authority to represent anything at all." The secretary occupies the same position in the company set-up as the secretary of a State does in political Government. He is the connecting link between the board of directors which is the principal executive authority in the company and the other staff of the company. Consequently, he ranks in importance next to the managing director or general manager of the company. He is required usually to deal with the share department, the correspondence, filing and records departments, the accounts department and the establishment department concerned with the recruitment and promotion of office staff. Briefly, the secretary has to deal with recording and communicating activities in the company. The actual assignment of duties depends upon the size of the company and its volume of work.

Rights and Powers. 1. The secretary being the head of the secretarial department has the right to control and guide the activities of the department under his care.

2. As a servant of the company, he has the right to demand his salary as a preferential claim in the winding up of the company.

3. Being a permanent and full-time officer of the company, he has the right to sign any document that requires the company's approval.

4. The secretary cannot make any allotment of shares unless he is specially authorized by the board or the Articles of the company.

5. Transfer of shares can be registered by him only if he is authorised by the directors to do so, otherwise shareholders may repudiate the transfer of shares.

6. The secretary is not an agent of the company, and in all contracts made by the company, he should make it perfectly clear that he signs as a scribe, not as a party. Accordingly, he cannot bind the

company by his self-assumed authority, and he becomes personally liable in such circumstances.

Duties and Responsibilities. In order to stress the importance of his duties to the board, the secretary is often referred to as the 'mouthpiece of the directors'. Generally speaking, the secretary of a company is required to discharge the following duties and responsibilities :

1. *Statutory duties*—The secretary has to observe the company law formalities from start to finish and is to see that necessary documents and statements are duly filed with the Registrar as well as that required books are maintained by the company. Requirements of the Income-Tax Act relating to the deduction and payment of requisite tax, and of the Indian Stamp Act for affixing proper stamp duty fall primarily upon the secretary as the principal officer of the company. In short, he is the officer who attends to all the legal requirements of the Companies Act and other related statutes.

2. *Duties to the members and the public*—The secretary virtually becomes the public relations officer of the company. He forms the mediating link between the board of directors, on the one hand, and the public composed of shareholders, creditors, debenture-holders, etc., on the other. He is entrusted with the 'common seal' of the company and enjoys the confidence of the directors. Consequently, he must see that confidential matters are not disclosed prematurely which may affect the interest of the company and the general body of shareholders. To be sure, the key to the speculation in shares is held by the secretary of a company.

3. *Duties relating to office work*—According to the size of the company and the volume of work, the nature of office duties varies from one case to another. In a small company, the secretary may be required to handle actually the affairs of several departments in regard to shares, correspondence,, records, accounts, statistics, etc. In a large company, his duties are often limited to the co-ordination of activities of several departments. An overall supervision of the communicating and recording activities, organized into several departments, is exercised by the secretary. But in a small company, there is usually one secretarial department subdivided into a number of sections or units, and he takes charge of the entire department.

4. *Duties to the board of directors*—The secretary's duties to the board are concerned with an all-round attendance upon the directors. As the directors act through board meetings, the secretary has to arrange for such meetings by giving notices to all the directors. At the board meeting, the secretary is required to provide the directors with information they ask for their deliberations, and after the meeting

he is to record the minutes and to put into effect their decisions. The will of the directors is conveyed to the staff through him, and the problems of secretarial work are brought to the notice of directors by him. In the eye of the law, the secretary is a servant of the board of directors, and as such, he must carry out its orders and instructions.

Liabilities. The secretary cannot be held liable for any act when he discharges his duties and responsibilities deligently and conscientiously. However, he becomes liable for his wilful misconduct and negligence. He is generally free from any liability for a fraud perpetrated by one of his assistants unless he is a contributory to such frauds. When the position of a secretary is combined with that of a director or manager, he attracts further liabilities associated with such offices. The secretary is liable, however, to misfeasance proceedings along with other officers of the company. To avoid his personal liability, the secretary must act only for, and on behalf of the company.

SHARES AND SHAREHOLDERS

Share Capital. The share capital of a company and its division into units of certain fixed values are stated in the Memorandum. Because the amount of capital is named or mentioned in the charter, the total share capital is called '*Nominal Capital*'. It is also known as '*Authorised Capital*' since the company is authorised by its charter to issue capital up to the extent stated therein. '*Registered Capital*' is another term for the total share capital, and it implies that the company is registered with that amount of capital. But it is the practice of almost all companies that the entire share capital is not offered for subscription. The portion of the nominal capital which is actually offered to the public for sale is called '*Issued Capital*'. The company cannot compel the investors to purchase all the shares offered by it, and accordingly, there may be a discrepancy between the shares offered for sale and the shares actually purchased. '*Subscribed Capital*' refers to that part of issued capital which is taken up by the public. Again, the full value of each share is not called up at a time, but it is collected in several instalments according to the financial requirements of the business. '*Paid-up Capital*' refers to the actual amount gathered by the company from the shareholders out of subscribed capital.

The excess of subscribed capital over the paid-up capital plus calls in arrears represents '*Uncalled Capital*'. This uncalled capital may be called up at any time by the directors, and the members are bound to pay the required call money. Shares on which calls have not been duly paid are liable to be forfeited by the board of directors. If permitted by the Articles, a company may accept from any member either

the whole or part of the uncalled amount on shares held by him, though the company has not yet made a call for it. Dividend may accrue on such larger payments which of course cannot carry any extra voting right. Sometimes, the company decides by a special resolution that the uncalled capital should not be called up except in the event of, and for the purpose of, the company being wound up. In that situation, the uncalled capital becomes '*Reserve Capital*' of the company for falling back upon such reserves in order to meet the claims of creditors on liquidation. Once transformed into reserve capital, it cannot be turned into ordinary capital without leave of the court; and it cannot be dealt with or charged by the directors.

The Companies Act provides that where a company makes publication of its authorised capital, it is bound to show with equal prominence the amount which has been subscribed and paid for. Failure to comply with this provision renders the company and its every officer liable to a maximum fine of Rs. 1,000. The object of this provision is to prevent under-capitalization and the drawing of a false picture of the company. In the past, companies were formed with a large amount of authorised capital, out of which a fractional part as low as 5% or 10% only was collected as paid-up capital. But this position relating to actual capital was kept concealed by the publication of authorised capital. Hence, it offered an opportunity to mislead the investors. To prevent this possibility, the simultaneous publication of subscribed and paid-up capital has been prescribed by the Act.

Shares and Stock. 'Shares' mean the divided units of share capital and include stocks also unless a distinction between share and stock is expressed. Shares are moveable property capable of being transferred in the manner fixed by the Articles of the company. Every share must have a number so that one share can be distinguished from another. For the issue of shares, the certificates must be issued by the company under its common seal specifying the shares held by every member. Share certificate is the primary evidence of a member's title to his shares, and it gives a right to receive dividend as well as a right to get capital refund on the winding up of the company.

The 'stock' refers to the aggregate amount of fully paid-up shares consolidated into one block. But for the purpose of transference, this consolidated amount is split up into units of any amount, irrespective of the original fixed value of each share. Like the share, the fractional unit of stock is represented by 'Stock Certificate'. The Articles of the company often provide that fully paid-up shares may be converted into stock for issuing them to the shareholders in denominations of their choice. The chief advantage of stock lies in the facility it gives to the shareholder by way of enabling him to transfer any part of his

share value. The company is also benefited through the saving of trouble in recording the distinctive number of shares, because the shares are merged into one lump amount of stock in which their identities are lost.

Shares can be differentiated from stocks in the following four respects :

a. Inasmuch as the fully paid-up shares are converted into stock, a company cannot issue stock directly to its members. Shares are to be issued first and they may be subsequently converted into stock. But shares can be issued directly when the company is incorporated, and they may be held as partly paid up or fully paid up.

b. Shares of a company have always fixed values, whereas stocks may be of varying amounts at the option of the members. Again, shares cannot be issued in any denomination which contains a fractional part of the rupee, but there is no such bar in the case of stock. For example, a stock of Rs. 10.50 can be issued, but not a share with such a value.

c. Shares bear distinctive as well as consecutive numbers while there are no such identifying numbers for stocks.

d. Shares can be transferred in their complete units ; that is, half the value of a share cannot be transferred. But any part-value of a stock may be transferred subject of course to the minimum amount that may be provided in the Articles for avoiding inconveniences of transfer.

Classes of Shares. Under the Companies Act, 1956, a public limited company can issue only two classes of shares : Preference and Equity.

PREFERENCE SHARES : Preference shares carry preferential right as regards dividend and repayment of capital. Out of divisible profits of the company, the preference shareholders have got a first claim for their usually fixed rate of dividend, and the residue of the profits is distributed among the equity shareholders who share profits next to preference shareholders. Preference shares are issued with three different characteristics ; the shareholders may possess these shares with one or more such characteristics attached. On the basis of their features, preference shares may be subdivided into the following categories :

a. Participating preference shares—The participating feature permits the preference shareholder to retain his fixed rate of dividend, and in addition to it, to participate in surplus profits or assets.

b. Redeemable preference shares—Share capital is not generally refundable by the company to its shareholders so long as the company remains a going concern. Redeemable preference shares provide an

exception to this rule. A company may issue preference shares which are redeemable or repayable at the option of the company after a certain fixed period. The Companies Act permits the issue of redeemable preference shares subject to five conditions : (*i*) the issue of such shares should be authorised by the Articles, (*ii*) shares should be fully paid up, (*iii*) they should be redeemed only out of profits or of proceeds of any fresh issue, and not out of sale proceeds of any property, (*iv*) any premium payable on redemption must be secured from profits or share premium money, and (*v*) in cases of redemption out of profits, a '*Capital Redemption Reserve Account*' should be created so that the share capital may remain unaltered.

Redemption of preference shares is not equivalent to the reduction of share capital. Any issue of shares up to the full amount of redeemed shares is not considered as an increase of share capital.

c. Cumulative preference shares—When dividends are not paid on this class of shares for a year or two, arrears of dividend accumulate in respect of such shares. All arrears of dividend must be paid as soon as the company makes any profit available for distribution among the shareholders. As a result, cumulative preference shareholders are assured of a fixed annual return, irrespective of earnings of the company. "Preference shares are presumed to be cumulative, any ambiguous language in the Articles will not be enough to make them non-cumulative. But they may be made non-cumulative by express provision or by any language which is sufficiently clear". (Topham).

EQUITY SHARES : Ordinary shares are called 'equity shares' because they rank last in receiving their reasonable rates of dividend. Equity share capital is defined in the Companies Act as "all share capital which is not preference share capital". Equity shareholders form the bulk of shareholders who participate in the division of profit next to the claims of all preference shareholders. Unlike the preference shareholders, they enjoy varying rates of dividend as recommended by the board of directors. During the early years of the company, they may not get anything, but when the company becomes established and the amount of profit increases, they are adequately compensated for the greater risks they assume by way of corresponding higher rates of dividend. Because of their assumption of risk, the equity shareholders are taken to provide the 'venture capital' of the business.

Voting Rights on Shares. Equity shareholders alone have the right to vote in the election of directors, and this voting right must be in proportion to the amount paid up on such shares. Preference shareholders have no right to vote except on resolutions which directly affect their interests. But if dividends fall in arrears for two years in the case of cumulative preference shares, and for three years in other

cases of preference shares, preference shareholders are given the same voting rights as are enjoyed by the equity shareholders.

This restriction on voting rights applies to public limited companies and their subsidiaries. Moreover, deferred shares which are referred to in the Act as shares with disproportionate voting rights, cannot be issued now by a public limited company and its subsidiary which may be a private limited company. But a private limited company, not being subsidiary of a public limited company, is entitled to issue shares with such voting right as it may like. Within a period of one year from commencement of the Act, all existing public limited companies were required to convert their deferred shares into equity shares through the adjustment of excess voting rights on such shares. The deferred share was a very inequitable form of share, since it used to carry three advantages, namely, (*a*) a low denomination or value of the unit of shares, (*b*) a high percentage of dividend, and (*c*) an excessive voting right, *e.g.*, a share of Re. 1 used to carry one vote as against an ordinary share of Rs. 10 with the same voting right.

Shares with and without a Par Value. In our country, shares are always issued in certain fixed denominations which are known as their *face value* or *par value*. Because of this par value, companies may find some difficulty in raising their capital. Shares may be required to sell at a lower price than the fixed value attached to them by the company. This selling of shares at a lower price is known as 'issue of shares at a discount' which is circumscribed by the Act in several ways. Further, when the issued shares are dealt in on the stock exchange, the market price bears no relation to this fixed value of shares. Shares may be sold at a premium or at a discount according to the market price going up and down respectively in relation to their par value. Strictly speaking, the par value is a fictitious value or deceptive label attached to a share, the value of which varies with changes in earnings as well as in accumulated reserves. The share capital of an existing company as shown in balance sheet may not represent correctly the value of business assets.

To avoid these shortcomings, no-par shares are at present being issued by the corporate enterprise of the U.S.A. and the U.K. Raising of capital is greatly facilitated by the issue of no-par shares. But no-par shares may be more easily manipulated by unscrupulous promoters than par-value shares which give a planned protection to the uninformed investors.

Issue of No-par Shares. In order to facilitate the raising of additional capital by existing companies, no-par shares have acquired some popularity in the U.S.A. and in the U.K. Several States in the

U.S.A. have permitted the issue of no-par shares by companies which have taken advantage of this facility. In the U.K., the findings of the last English Company Law Committee under the chairmanship of Mr. Cohen have been reversed by the Gedge Committee in 1954. The Gedge Committee observed that no-par shares would involve no greater risk or abuse than shares having a par value, and on the contrary, they would ease the issue of shares to a great extent.

The share certificate of no-par shares states the number of shares to which it evidences ownership without mentioning the par value of each share, as in the case of certificates for par-value shares. The aggregate ownership of the company is simply divided into certain shares, the value of which is automatically adjusted to the real net worth of the company. The question of difference between the nominal value and the market price of shares does not arise, and the selling of shares at a premium or at a discount becomes irrelevant. Dividends are paid by way of a given amount per share instead of as a certain percentage of the fixed nominal value of shares.

The following are the advantages of no-par shares :

1. Watering of stock due to the overvaluation of assets in the balance sheet is stopped by the issue of no-par shares. The balance sheet represents a realistic picture of the enterprise in terms of its real worth of assets instead of the fictitious value that is shown in respect of par-value shares.

2. The shareholders are not placed in a doubtful position about the real value of their shares, since the value of shares is intimately linked up with the earnings of the company.

3. As the entire value of no-par share is collected in one sum that it fetches in the market, the shareholders are relieved of the liability from paying future calls on shares.

4. The raising of additional capital is greatly facilitated, since the shares can be issued at a price that is commensurate with the conditions of the capital market. Legal formalities and restrictions do not prevent the marketing of shares on the questions of discount, brokerage or commission on shares.

5. The reduction of share capital does not become necessary in the case of no-par shares. According to the earning capacity, the value of shares is automatically adjusted.

The disadvantages of no-par shares may be stated as follows :

1. The planned protection of par-value is lost to the uninformed investors. The fixed value provides a standard by which any deviation in price can be judged as to be favourable or unfavourable.

2. It offers enough scope to unscrupulous management for manipulating the sale proceeds of shares and the payment of dividend out of capital.

3. The balance sheet may become unintelligible to the ordinary investors, creditors and others. Taxation becomes complicated and tax evasion is facilitated.

4. In the case of par-value shares, the uncalled share capital provides the creditors with an additional security that may be relied upon by them. But the creditors are deprived of this facility in the case of no-par shares, as no reserve capital can be created under the method.

In recent years, the issue of no-par shares is losing its ground in the U.S.A. From the standpoint of the issuing company, the two important benefits were tax facility and capital flexibility. The tax facility has been removed in that country by amending the tax laws. As regards flexibility in the raising of capital, low par-value shares are serving the same purpose. Hence, the importance of no-par shares has been reduced.

Issue of Shares at Premium and Discount. Shares can be issued at a premium, but the amount of premium must be transferred to a "*Share Premium Account*". The amount so transferred can only be applied for certain specified purposes, such as issue of bonus shares, writing off preliminary expenses, and payment of commission on shares, premium on redemption of debentures or preference shares.

A company may also issue shares at a discount if authorised by a resolution of the company in general meeting and sanctioned by the court. The maximum rate of discount should not exceed ten per cent without the approval of the Central Government. The Government may allow higher percentage in special cases. Shares cannot be issued at a discount before one year from the date of receiving the commencement certificate and they should be of a class of shares already issued. Within two months after the date on which the issue is sanctioned by the court, shares are to be issued at a discount. For the issue of shares at a discount, an allotment return is to be filed with the Registrar together with a copy of resolution, a copy of court's order and the Government order, if necessary. Particulars of discount allowed and the amount written off therefrom must be mentioned in every subsequent issue of the prospectus. Default in this respect makes the company and its officers liable to a fine of Rs. 50.

Right Shares. Where a company intends to increase its subscribed capital by the issue of additional shares after the first allotment, it must offer the further shares first to the existing equity shareholders in proportion to their holdings. Only on their refusal to accept the offer within a prescribed period of 15 days or more, these shares can be offered to the outside public. The Companies (Amendment) Act, 1960 provides that further shares can be offered to any persons under

the authority of a special resolution or of a proposal that is carried out by majority votes in the general meeting. These shares are known as Right Shares, because the existing shareholders have an inherent right or privilege to subscribe the shares with a view to retaining their control over the company. Right shares are always offered at a concessional rate to the existing shareholders. Where the old shares are selling at a premium in the stock market, new right shares are offered at par, and in cases of old shares selling at par or below par in the market, right shares are offered at a price lower than the market price.

Bonus Shares. Companies with a large reserve fund built out of past undistributed profits may give the benefit of this accumulated profit to the existing members by way of issuing bonus shares to them. The Articles must permit this issue of bonus shares ; and such shares are required to be offered to the members in accordance with their holdings and dividend rights. Issue of bonus shares is a device by which past profits are capitalized, i.e., profits are utilized to pay up new shares by means of a book entry only. It results in the payment of dividend in the form of partly or fully paid-up shares. Since 1955-56, issue of bonus shares was subject to a tax of 12½%, the rate of which was increased to 30% during the three intervening years from 1957-58 to 1960-61. With the abolition of this tax in 1966-67, the issue of bonus shares has become common with the companies in our country.

DEBENTURES

Debenture is an instrument issued by the company under its common seal acknowledging a debt and setting forth the terms and conditions of its issue as well as of its ultimate repayment. The Act describes debentures to include 'debenture stock, bonus and any other securities of a company with or without any charge on its assets.' Debentures and bonds represent, therefore, creditorship securities of the company involving its long-term debts. Like the shares, debentures have certain fixed denominations and may be issued at par, at discount or at a premium. The formalities and procedure for the issue of debentures are almost the same which are required in the case of shares. But unlike the shares, debentures may not carry any voting right to be exercised at the general meeting of the company. Like the stock again, the debenture stock can be issued by a company in contrast to its debentures. "The difference between a debt secured by debentures and debenture stock is very like the difference between shares and stocks". (Topham).

Classification of Debentures. Debentures may be classified as follows :

Secured and unsecured debentures—When the debentures are

issued without any charge on the company's assets, they are known as '*naked debentures*'. Issue of naked debentures is not very common with the companies. In most cases, debentures are secured by a charge, either fixed or floating, upon the assets of the company. Under a fixed charge, a specific asset or a number of assets are pledged as security for the loan obtained through debentures, thereby the titles of such pledged assets become incapable of being transferred by the company to other persons. In the case of debentures with floating charge, the general assets of the company are charged for the repayment of debentures, and the company is free to deal with its assets in any way it thinks fit. Debenture issues are very often secured by a trust deed under which the property is mortgaged to the *trustees for debenture holders*, and in default of the payment of interest or repayment of principal, trustees are usually authorised to sell the mortgaged property for the purpose of paying off the debenture holders.

Redeemable and irredeemable debentures—Redeemable debentures are made repayable after a certain time or on a certain date. Irredeemable debentures, on the other hand, are not repayable as such. Nevertheless, it does not imply that they are never to be paid back; they may be repaid by the company at its option after the expiry of a certain minimum period. Irredeemable debentures are also known as *perpetual debentures*. Moreover, if the company makes default in the payment of interest on its perpetual debentures, the holders thereof are entitled to claim back the loan given to the company.

Registered and bearer debentures—Bearer debentures can be transferred by mere delivery of the debenture instruments, whereas registered debentures are only transferable by a properly executed deed and the delivery of the instruments. Further, names of registered debenture holders are recorded in the books of the company, while there is no such necessity of recording the names of bearer debenture holders.

Collateral debentures—Debentures are often issued by a company with the object of offering security for short-term loans and advances obtained from bankers and others. So long as the company fulfils the terms of such loans, debentures are treated as dormant. Only in case of failure to pay interest or to repay the principal sum, the creditors take up the debentures for the purpose of enforcing the terms of loan. When the loans are fully repaid, debentures are automatically cancelled because of their object of creation being terminated.

Shares and Debentures. The following are the chief points of distinction between shares and debentures.

1. *Ownership and creditorship*—Shareholders are owners of the company and they carry the ownership securities of the company. Debenture holders are creditors and they hold the creditorship securities of the company.

2. *Dividend and interest*—Shareholders are entitled to get a varying rate of dividend as recommended by the board of directors out of profits only. Debenture interest must be paid at a fixed rate for all years, even if there is no profit. Interest must be paid within due dates, otherwise such interest becomes subject to further interest. Interest is to be paid after deducting income-tax therefrom. On the other hand, payment of dividend may be delayed up to the permissible limit of 60 days, and it may be declared either free of income-tax or less income-tax. Again, in contrast to the practice of paying annual interest, interim dividend may be paid ; but call money received on shares in advance may not earn any dividend.

3. *Control*—The shareholders of the company control its affairs. They take the major risks of business, and therefore, demand the right to elect the directors of the company and to vote on fundamental policies of the company. Debenture holders have generally no control over the affairs of the company ; but they want to have an assured income. Only when management fails to provide ample protection to the interests of debenture holders, they are allowed to have some say in managing the company.

4. *Security of principal*—Debenture holders rank first in the repayment of their investments along with the payment of interest. Debentures are usually secured by a charge on the company's assets. Repayment of shareholders' investment is postponed to the claims of debenture holders and other creditors. Shares are not issued against a charge on the assets which remain free for further borrowings. Debenture money is usually repayable after a certain period, whereas share money is not refundable to the shareholders except in the case of redeemable preference shares.

5. *Reconstruction*—On the reconstruction and reorganization of a company after failure, the debenture holders fare better than shareholders. The burden of reconstruction falls entirely upon the shareholders, and debenture holders may escape unhurt.

Kinds of Securities. Shares, stocks and debentures form the three major groups of securities of a company. Because of their activities, company securities go by the name of *industrial securities* or *industrials* as distinct from Government securities which represent long-term public borrowings. From the standpoint of their transferability, the company securities may be divided into three categories :

Registered securities—In the case of registered security, names of holders are required to be recorded in the company's register, and such securities can be transferred by the execution of a transfer deed. Transfer is completed only when the transferee's name is recorded in the company's books and a new certificate is issued in favour of the

transferee or the old certificate is endorsed with the name of the transferee.

Bearer securities—Bearer securities, on the other hand, are transferred by mere delivery, and the names of holders need not be recorded in the company's books. As regards stamp duty on the transfer of bearer securities, they call for the payment of a higher duty for one time only, and duties are not paid on each transfer as in the case of registered securities. Companies are relieved of the trouble of drawing up dividend lists or interest lists, since a number of *Interest Coupons* or *Dividend Coupons* as the case may be, are attached to enable the holders to collect the amount when it falls due. Bearer securities encourage speculation in securities and lead to the evasion of income-tax.

Inscribed securities—The transfer of securities may be managed by a transfer agent who is usually a banker. When it is managed by a transfer agent, the transferee does no get any certificate but his name is inscribed or recorded in the books of the agent who issues *dividend warrants* to the holder of securities so as to enable him to obtain dividend or interest from the company. The Allahabad Bank for example, is acting as the transfer agent in respect of securities issued by the Indian Iron & Steel Co. Ltd.

METHODS OF MARKETING SECURITIES

There are three methods by which a company can get its securities subscribed, namely, direct placement through prospectus, indirect placement through brokers and private placing through underwriters. Under the prospectus method, the company makes a direct appeal to the investors by means of an advertising campaign. Direct selling is economical and convenient provided the subscribers are confined to a limited area and are small in numbers. But in the case of a wider market composed of the general investing public, this direct method often fails to achieve the desired result. Uncertainty of the market is the stumbling-block to this method. However, an established concern can sell its 'right shares' through this method only by the issue of a circular.

The second method involves the appointment of stock-brokers who procure subscription for securities as agents of the company on a commission basis. Investment bankers and other financial institutions may also act as intermediaries to push the shares in the market. But uncertainty of selling is also present in this method, since the brokers do not give any guarantee for the sale of entire securities. They charge brokerage from the company on the basis of actual business done by them.

In order to remove the defects of the above two methods, the underwriting method is often resorted to by companies. Underwriters

guarantee the sale of securities in advance of the placing of securities in the market. In the event of the public not taking up the whole of securities, underwriters agree to purchase securities on their own account. Underwriting amounts to insuring the sale of securities, and thereby the company promoters are relieved of the uncertainty of the market. They are remunerated at a flat rate of commission on the entire lot of securities. The only defect of this method lies in its comparative higher costs involved, as the percentage of commission is much higher than the brokerage charge.

In recent years, the underwriting operations have acquired much importance in our country. In collaboration with the IDBI and the LIC, the finance and development corporations and some leading commercial banks have underwritten securities amounting to Rs. 34.5 crores in 1969, Rs. 39.1 crores in 1970, Rs. 19.7 crores in 1971 and Rs. 54.9 crores in 1972. As regards proportion of underwriting to total issues, the percentage has increased from five in 1951 to more than ninety in 1965 and afterwards. The percentage of shares underwritten to net issues came to 90 in 1969, 98 in 1970, 86 in 1971 and 93 in 1972. The percentage of debentures underwritten to net issues stood uniformly at 100 from 1962 to 1972 except in 1967 and 1968 when it declined to 99. In 1972, the IDBI became the largest underwriter of shares representing 27.3% and the LIC became the largest underwriter of debentures representing 26.4% of the total amount underwritten among the institutional underwriters.

Brokerage and Commission. A company can pay any commission for issuing its securities subject to the following conditions :

a. That the payment of commission is authorised by the Articles ;

b. that the rate of commission does not exceed either 5% of the price at which the shares are issued or the maximum rate authorised by the Articles, whichever is less ; for the subscription of debentures, the rate is $2\frac{1}{2}$% ;

c. that the amount or rate agreed to be paid is disclosed in the prospectus along with the number of shares and debentures desired to be subscribed ;

d. that commission is paid only on those securities which are offered to the public for subscription and a copy of the contract for the payment of commission is delivered to the Registrar along with the prospectus ; and

e. that commission is not paid out of the sale proceeds of shares or by the allotment of shares.

About the payment of brokerage, the Act does not prevent a company from paying any brokerage that is either customary or lawful for such a company to pay.

EVIDENCE OF SHARE OWNERSHIP

The evidence of members' title to their shares is given in two different ways : by the share certificate and by the share warrant.

Share certificate—A certificate of shares issued by the company under its common seal is the *prima facie* evidence of title to the shares. Companies are required to make the share certificates complete and ready for delivery within 3 months of the allotment of shares and within two months after the application for the registration of share transfer. Share certificates should state the number and class of shares, the amount paid on them and the name of the holders thereof. Before the issue of this share certificate, a provisional certificate known as 'share scrip' or *scrip certificate* is generally issued by companies. Although the share certificate is not a negotiable instrument, it may be transferred by endorsement and delivery. A specimen of the share certificate is given below.

FORM OF SHARE CERTIFICATE

<table>
<tr><th>Counterfoil</th><th>Certificate of Ordinary Shares</th></tr>
<tr><td>
Name of shareholder . . . .

Address . . . .

Description . . . .

For . . . . shares

Nos. . . . . to . . . .
inclusive.

Date of certificate . . . .
Date delivered . . . .

Folio in register . . . .

. . . .
(Member's signature)
</td><td>
No. . . . . . . The X Y Z Co., Ltd.
Capital, Rs. 10,00,000 divided into 1000 6% Pref. Shares of Rs. 100 each and 90,000 Ordinary Shares of Rs. 10 each.

This is to certify that. . . . . .of. . . . . .is the registered holder of. . . . . .ordinary shares of rupees ten each, numbered. . . .to. . . .inclusive, subject to the Memorandum and Articles of the company, and that the sum of rupees eight has been paid up in respect of each of such shares.

Given under the Common Seal of the Company, this Seventh day of May, 19. . . .

Common
Stamp
Seal

. . . .
. . . .
Directors

. . . . .Secretary
Note—No transfer of any of the within-named shares will be registered without the production of this certificate.
</td></tr>
</table>

Share warrant (Bearer share)—If authorised by the Articles and approved by the Central Government, a public limited company may issue share warrants in respect of its fully paid-up shares. A company under its common seal issues share warrants which state that the bearer of a warrant is entitled to the share specified therein. Share warrants are negotiable instruments, and they pass from hand to hand by mere delivery of the instrument. Share warrants are usually supported by dividend coupons which enable the shareholders to collect dividends from the company.

Unless the Articles provide otherwise, holders of share warrants are not treated as members of the company, and their names are removed from the register of members. On the issue of a share warrant, companies have to enter the following particulars in their register of members : (*a*) the fact of the issue of the warrant, (*b*) a statement as to the particulars of shares along with their numbers covered by the warrant, and (*c*) the date of issue of the warrant.

If permitted by the Articles, the bearer of a share warrant is, however, entitled to have his name entered in the company's register as a member on the surrender of warrant for cancellation and on the payment of requisite fees. A specimen of the share warrant is given below.

FORM OF SHARE WARRANT

Counterfoil	Share Warrant
The A. B. C. Company Ltd. For 100 shares. numbered . . . . to . . . . inclusive No. of certificate exchanged Issued to . . . . Name . . . . Address . . . . Dated, ... Folio in register . . . . (Member's signature)	The A. B. C. Company Ltd. Stamp Share warrant No. . . . . . .for 100 shares This is to certify that the bearer of this warrant is entitled to one hundred fully paid up shares of Rs. 10 each, numbered. . . . . to. . . . . . . .inclusive in this Company, subject to the Articles of Association of the Company and the conditions endorsed therein. Given under the Common Seal of the Company, this Tenth day of March, 19. . . . Common Seal . . . . Directors . . . . .Secretary

Share Certificate vs. Share Warrant. The nature of these two documents can be better appreciated by drawing a contrast between them in the following way :

1. The share certificates are issued in the first instance to every shareholder when the shares are initially allotted, but share warrants may be subsequently issued by a company, provided the Articles give such permission in respect of fully paid-up shares only.

2. The holders of share certificates are entitled to get their names registered in the company's book as members, whereas the holders of share warrants do not enjoy such right.

3. The share evidenced by the certificates can only be transferred by the execution of a proper transfer deed, but the shares enumerated in a warrant can be transferred by mere delivery of the warrant.

4. The shares specified in the certificates can constitute the qualification shares of directors, but the shares covered by a warrant are not counted for the purpose of qualification shares.

5. The holders of share certificates are members of the company and can exercise voting rights, but the holders of share warrants are not entitled to such privileges.

6. A winding up petition can be made only by the holders of share certificates, and not by the warrant holders.

Registered Transfer. Shares are movable property and can, therefore, be transferred from one person to another. In order to transfer shares, a shareholder has to lodge with the company the share certificate or the letter of allotment together with a transfer deed duly stamped and executed by both the parties. In the case of partly paid shares, the company must give proper notice of the fact to the transferee who may object within two weeks from the receipt of the notice. Having no objection from the transferee, the company can effect the transfer of share.

The directors are usually empowered by the Articles to refuse the registration of a transfer of share on which calls are in arrears. Directors may also refuse to register any transfer at their discretion in the exercise of powers contained in Articles. A remedy against this discretionary power is now available to shareholders of a company. Shareholders can make an appeal to the Central Government within two months of such refusal for obtaining a suitable relief. In cases of refusal to register share transfer, the company is required to give notice to both the transferor and the transferee within two months from the date of application. The penalty for contravention is Rs. 50 per day of default. For obtaining relief from the Government, the affected shareholder is to make a petition to the Government in writing accompanied by a fee not exceeding Rs. 50. If default is made in giving

effect to the Government's order within the specified period, the company and its every officer are liable to a fine up to Rs. 1,000 and a further fine of Rs. 100 for each day of default.

If the board of directors decides to accept the transfer, the name of the transferee is to be entered in the register of members. Necessary share certificate should be completed and made ready for delivery within two months after the application for the registration of transfer. Where the whole lot of shares is evidenced by a single certificate and a holder desires to transfer a part of his shareholdings, the transfer is required to be certified by the company. The certification of transfer involves the deposit of existing share certificate with the company which issues a new certificate in respect of transferred share and a 'Balance Receipt' or a 'Balance Ticket' relating to the unsold shares.

Blank Transfer. The process of transfer in which the share certificate is simply signed by the transferor and the certificate is kept blank relating to other particulars of transfer (viz. the name of the transferee, the date of execution, etc.) goes by the name of blank transfer. The object of a blank transfer is to facilitate negotiability of shares without getting the transferee's name registered in the books of the company. Shares are usually transferred in blank when they are offered to bankers as security for obtaining a loan. It is advantageous to bankers and other lenders who may fill in the certificate with their names as transferees and get the transfer registered in the company's books, when the loan is not repaid in time. Blank transfers encourage speculation in shares and they are responsible for the evasion of income tax and stamp duty. But a blank transfer gives an equitable title to the transferee, and as such he can retain the shares against any other person only when he becomes a *bona fide* holder of securities for value in good faith.

The Companies (Amendment) Act, 1965 has placed restrictions on blank transfer, and this provision has been enforced from 1st April 1966. The Act provides that every instrument of transfer of shares must be in the prescribed form bearing the date of issue stamped by the prescribed authority. In the case of listed securities, the instrument is to be delivered to the company at any time before the closure of members' register for the ensuing meeting and in other cases, within two months from the date of issue.

Mortgage of Shares. As the shares are movable property, they can be given in a mortgage by the shareholder. A mortgage of shares may be either of the following types:

Legal Mortgage—It requires the drawing up of a mortgage deed in which the terms and conditions of the mortgage, the particulars of

shares along with their numbers and the right of the mortgagor to get the share re-transferred on repayment of the loan, are incorporated. The shares are transferred to the mortgagee whose name is registered as a member in the company's book for the time being. The mortgage deed empowers the mortgagee to sell the shares in case of failure to repay the loan within a stipulated time. In other words, legal mortgage amounts to a formal transfer of shares with a right of re-conveyance of shares to the original owner.

Equitable Mortgage—It is created by the deposit of the share certificate and a blank transfer form duly signed by the transferor (mortgagor) with the mortgagee. The share certificate is given as security for the loan obtained, and the blank transfer form protects the interests of lender who may get the shares transferred in his own name in cases of default. Like the legal mortgage, the terms and conditions of the loan and the power of the lender to sell the shares in cases of necessity are embodied in the mortgage deed.

Transmission of Shares. Involuntary transfer through the process of law consequent upon the death or insolvency of a member is known as transmission of shares. The ownership pertaining to shares of a deceased member vests in his heirs or representatives and his estate becomes liable for calls on shares. The right to transfer the shares of an insolvent member vests in the official assignee or the receiver. As opposed to the voluntary method of transfer through a sale or mortgage, the transmission involves the transfer of shares by the operation of law.

Lien & Forfeiture. The Articles generally bestow upon the company a right to lien on the shares held by the members for their debts due to the company. This lien may originate in unpaid calls or in other circumstances, and it continues until the claim is satisfied by the member. The lien on shares involves an equitable charge upon the shares which can be sold out to meet the dues from the members. But the company is not entitled to enforce the lien by the forfeiture of shares. The company's lien on its shares prevails over other claims on such shares, unless the other claims have been made before the rise of the company's lien by an outsider with due notice to the company.

The right to forfeit shares for non-payment of calls is provided for in the Articles of all companies, since it ensures prompt collection of call money from shareholders without resorting to the tardy and expensive process of litigation. The board of directors is empowered by the Articles to exercise the power of forfeiture in a *bona fide* manner for the benefit of the company. The affected members must be intimated by a proper notice, otherwise the forfeiture will be invalidated.

The effect of forfeiture of shares is to expel the shareholder as a member whose rights and interests are appropriated by the company. The forfeited shares are subsequently re-issued by the company to other persons at a discount, the amount of which should not exceed the sum previously collected from the expelled member. The forfeiture of shares enables the company to make up adequately the loss arising out of shareholders' failure to pay call money on shares.

BOOKS OF THE COMPANY

Every limited company is required to maintain certain books for the purpose of recording financial transactions and other operational details relating to the company. These books may be classified under two groups :

a. Statutory or Compulsory Books.
b. Optional or Statistical Books.

Statutory Books. The Companies Act requires every limited company to maintain the following books :

1. A Register of Members with an index, where necessary.
2. A Register of Debenture Holders with an index, if necessary.
3. A Register of Mortgages and Charges.
4. A Register of Directors, Managing Directors, etc.
5. A Register of Directors' and Chief Executives' Shareholdings.
6. A Register of contracts and concerns in which directors are interested.
7. A Register of Investments showing investments in companies under the same group as well as investments not held in the company's name.
8. Annual Return and Summary of Share Capital.
9. Minute Books concerning General Meetings & Board Meetings.
10. Account Books.
11. Duplicate Branch Register for a foreign branch, if any.

Optional Books. The optional books which are usually maintained by a company may be enumerated as follows : (*i*) Application and Allotment Book, and Call Book, (*ii*) Share Certificate Book, (*iii*) Register of Share Transfers, (*iv*) Register of Certified Transfer, (*v*) Register of Balance Ticket, (*vi*) Register of Share Warrants, (*vii*) Register of Documents Sealed (common seal), (*viii*) Dividend Book and Debenture Interest Book, (*ix*) Directors' Attendance Book, (*x*) Agenda Book, and (*xi*) Register of Probates.

Register of Members and Index. Every company must keep a register of its members showing therein particulars of each member

regarding (*a*) name, address and occupation, (*b*) identifying numbers of shares and their paid-up value, (*c*) dates of becoming and ceasing to be members, and (*d*) amount of stock held.

When the register is not kept in the form of an index, a separate index of members should be maintained by companies having more than 50 members. This register is available to inspection or to taking extracts by every member and debenture holder without a fee, and by any other person on the payment of a fee of rupee one.

Register of Debenture Holders. Every company is required to maintain a separate register of debenture holders on identical lines with the register of members. Keeping of an index is also guided by the same considerations. Like the register of members, this register also is open to inspection by members and non-members.

Register of Mortgages and Charges. Particulars of all mortgages and charges affecting the company's property must be recorded in this register by all companies. This register should contain a short description of the property charged, the amount of the charge and the names of persons entitled to the charge. The register of charges along with the instruments creating charges is open to inspection by members and debenture holders gratis, and by others on the payment of a fee of rupee one.

Annual Return. Every company must file an annual return with the Registrar of Companies within sixty days from the date of annual general meeting. The return must contain the particulars specified in Part I of Schedule V to the Act, and it must be in accordance with the form given in Part II of that Schedule. The return should be signed by one of the directors as well as by the managing director or others with a view to signifying the completeness and correctness of the return. A private limited company is required to state further that no public offer of its securities has taken place since the last return, and that it has complied with other conditions of private limited companies.

The particulars to be given in the return by a company include (*a*) its registered office, (*b*) the register of its members, (*c*) the register of its debenture holders, (*d*) its shares and debentures, (*e*) its indebtedness, (*f*) its members and debenture holders, past and present, and (*g*) its directors, managing directors, secretaries and managers, past and present. A copy of the balance sheet as laid down in general meeting should accompany this return.

The annual return is split up into six sections :

1. *Address* of the registered office of the company.

2. *Situation of Registers of Members and Debenture Holders* giving the address of place, whether within or outside the country, at which these registers are kept.
3. *Summary of Share Capital and Debentures* indicating their nominal values, subscribed and paid-up amounts, calls unpaid, discounts allowed, commissions paid thereto, etc.
4. *Particulars of indebtedness* of the company in respect of all mortgages and charges.
5. *List of Past and Present Members* showing their names, addresses or occupations and the number of shares held by each.
6. *Particulars of Directors and other Management Personnel* indicating their names, addresses and occupations.

COMPANY MEETINGS & THEIR FORMALITIES

Shareholders' meetings may be divided into two categories : (1) Ordinary General Meetings and (2) Extraordinary General Meetings. Ordinary General Meetings are of two kinds again—(*a*) the Statutory Meeting or the First General Meeting, and (*b*) the Annual General Meeting.

Statutory Meeting. It must be held within a period of not less than one month and not more than six months from the date at which the company commences its business. The object of this meeting is to acquaint the members with the financial position of the company. However, private limited companies are exempt from holding this meeting. A report known as Statutory Report must be sent together with a notice of the meeting to every member of the company at least 21 days before the date of the meeting. The Statutory Report must disclose the following particulars :

i. The number of shares allotted showing the amount paid up and the consideration for allotment.

ii. The cash received by the company for shares allotted.

iii. An abstract of receipts and payments made up to a date within seven days of the report, and an estimate of *preliminary expenses* showing separately commission on shares.

iv. The particulars of contracts proposed to be modified at the meeting.

v. The names, addresses and descriptions of the directors, auditors, managing directors, etc.

vi. The extent to which underwriting contracts, if any, has been carried out.

vii. The arrears due on any calls from the directors, managing directors, etc.

viii. The particulars of any commission or brokerage paid to the directors, managing directors and others for the issue of company's securities.

The secretary of the company should prepare the report and get it certified as correct by at least two directors and by the company's auditors. A copy of the statutory report is also required to be submitted to the Registrar before the statutory meeting. At the meeting, any matter relating to the formation of the company may be discussed, and the shareholders may be acquainted with one another through the list of members kept ready for inspection. If the statutory meeting is not held in time, the company is liable to winding up, and the directors along with other officers are punishable with a fine up to Rs. 500.

Annual General Meeting. Every company must hold an annual general meeting during the year in addition to any other meetings, and such annual general meetings should be held within 15 months of the previous general meeting. The first annual general meeting may be held within 18 months from the date of incorporation. If the first annual general meeting is held within that period, the company is not required to hold any annual general meeting in the year of its incorporation or in the following year. Except the first annual general meeting, the Registrar may extend the time of holding any annual general meeting by three months for any special reason. Furthermore, the presentation of annual accounts and balance sheet at annual general meetings cannot be delayed by more than 9 months in the case of first meeting and 6 months in the case of subsequent meetings after the close of the financial year. The board of directors is required to call this meeting by giving a notice to all members of at least 21 days before the date of the meeting. If the directors fail to call this meeting, it may be called on the requisition of the shareholders as well as on the direction of the Central Government or of the Court. The notice of the meeting must specify the matters to be discussed at the meeting and it should be accompanied by a copy of the audited balance sheet and the profit and loss account together with directors' report, chairman's speech, etc. The businesses that are transacted at such meetings include (*a*) consideration of the audited accounts, (*b*) declaration of dividend, (*c*) election of directors, (*d*) appointment of auditors, and (*e*) any other routine business. If the annual general meeting is not held in time, the company and its every officer are liable to a fine of Rs. 5,000 and to a recurring daily fine of Rs. 250.

Extraordinary General Meeting. Apart from the statutory and annual general meetings, extraordinary meetings are to be called for

obtaining the approval of the shareholders in certain special matters. If an urgent business is to be transacted before the next annual general meeting, the directors should call this meeting by giving a notice of 21 days. It may also be called by the members who hold at least ten per cent of the total voting rights. For this purpose, the members first place a requisition for the meeting with the directors who are supposed to convene the extraordinary meeting within 21 days thereof. If the meeting is not held within 45 days of the requisition, the requisitionists themselves are entitled to hold this meeting within a period of three months.

Directors' Report. The Companies Act requires that a directors' report should be attached to every balance sheet dealing with matters like (*a*) the general condition of the company's business, (*b*) the disposal of the company's profit by way of dividends to be declared and reserves to be carried forward, and (*c*) material changes and commitments affecting the financial position of the company from the end of the financial year to the date of the report.

Chairman of the Meeting. The Articles of the company usually provide for a permanent chairman. Otherwise, the members present elect the chairman of a meeting from amongst themselves by a show of hands. It is also provided in the Articles that the chairman of the board of directors would be the chairman of the general meeting of the company.

The chairman is to preside over a meeting and is the chief authority in the conduct and control of the proceedings of the meeting. It is the duty of the chairman to see that the meeting has been properly convened after a proper notice, and that the requisite quorum is present. He must preserve order in the meeting and conduct the meeting according to the arrangement of items in the agenda. He must see that the sense of the meeting is properly ascertained on any question placed before it, and that the views of the minority are not suppressed. He declares the result of voting and his decision is final, unless otherwise decided by a court. In addition to his deliberative vote as a member of the company, the chairman can exercise a casting vote when there is a tie. The chairman has powers to adjourn a meeting, to remove a disorderly member from the meeting, to stop discussion on a matter, and to decide points of order as well as priority of speakers. The chairman's speech is usually circulated among the members along with the directors' report before the annual general meeting.

Other Formalities of Meeting. *Quorum*—A quorum is the minimum number of persons who must be present at a meeting so that it

can validly transact any business. Unless the Articles provide for a larger quorum, the quorum for a general meeting consists of five members who must be personally present in the case of public limited companies, and two members in the case of private limited companies including Section 43A public limited companies.

Proxy—Every eligible member can delegate his right to attend the meeting or to vote at the meeting to another person who is known as proxy. That is, the proxy is a person who is authorised to act or vote for a member at any meeting of the company. A proxy may be any person whether a member of the company or not. A proxy is entitled to cast his vote only on a poll method of voting and he cannot speak on behalf of the member at a meeting. The proxy is appointed by a written instrument which must be stamped properly and deposited with the company before 48 hours or such longer time as may be specified. Companies having no share capital do not generally extend this privilege to their members.

Voting—There are several methods of voting through which the sense of meeting can be ascertained. Out of these methods, voting by acclamation or voice, voting by division and voting by ballot are comparatively unimportant. Voting by show of hand and voting by poll are the usual methods adopted by the companies. Under the voice voting method, the members are required to express their consent and dissent by saying 'yes' or 'no'. Under the division method, the members are asked to be divided into two opposing blocs the numbers of which are counted by the tellers or scrutineers. Under the ballot method, the members record their votes on ballot papers which are collected from them for the purpose of counting and declaring the result.

a. SHOW OF HANDS : On a show of hands, each member has only one vote, irrespective of the number of shares held by him. Moreover, absentee members cannot cast their votes under this method of voting. Although this method is followed by all guarantee companies without a share capital, it is not an equitable method of voting in the case of limited companies. However, the motions are decided first by a show of hands in the case of all companies. A motion is a proposition placed before a meeting and becomes a resolution only when it is adopted by the meeting. Under this method, the members are required to raise their hands separately in favour of the motion and against the motion.

b. POLL : The principle of one vote for every share is followed in this method only. All the members, whether they are present in person or by proxy, can exercise their voting rights in proportion to the shares held by them. A poll may be

demanded either by the chairman himself, or by certain members at any time of the meeting. The Articles of the company generally contain regulations as to the manner and circumstances of demanding poll, and these regulations should be followed in the conduct of this voting. Unless the Articles provide otherwise, every shareholder has one vote for each share or for each hundred rupees' stock held by him. Only a member whose name appears in the company's register of members is entitled to vote under this method. The members cast their votes 'for the resolution' and 'against the resolution' on voting papers which are counted for declaring the results thereof.

RESOLUTIONS

There are three different types of resolutions which can be passed in company meetings :

Ordinary Resolution. It is passed by a simple majority of members voting in person or by proxy at a general meeting, 21 days' notice of which has been given to the shareholders. An ordinary resolution is required to carry out routine matters like passing accounts, declaring dividend, electing directors, appointing auditors, etc.

Special Resolution. It requires 21 days' notice and has to be passed by a three-quarters majority of votes taken either by show of hands or on a poll at any general meeting. In other words, the number of votes cast in favour of the special resolution should be three times the number cast against it The notice must specify clearly the intention to propose the resolution as a 'special resolution'. Special resolution deals with special matters, such as reduction of share capital, creation of reserve capital, alteration of the Articles, and alterations of the name, objects and situation clauses of the Memorandum.

Resolutions Requiring Special Notice. The Companies Act has abolished the extraordinary resolution and has introduced this resolution instead. The Act has provided that resolutions on certain matters should only be passed after a special notice. A notice of the intention to move such a resolution is required to be given to the company at least 14 days before the date of the meeting, and the company in turn must give its members 7 days' notice of such resolutions. This resolution is required in the following cases :

1. To appoint an auditor other than the retiring auditor, and

2. to remove a director before the expiry of his term and to appoint another in his place.

MINUTES

Minutes are records of proceedings at meetings and serve as an aid to memory for showing evidence of decisions, facts or discussions at such meetings. The Companies Act, as amended in 1960, requires all companies to keep minutes of all proceedings of every general meeting, of every board meeting or of every meeting of any committee of directors. Minutes are to be kept by making entries in separate minute books for each type of meeting within thirty days from the date of meeting. All minute books must have consecutive page numbers ; each page of every such book must be signed or initialled and the last page containing records of individual proceedings is to be dated and signed by the chairman of the pertinent meeting or the chairman of the next meeting. Minutes of proceedings must never be kept by way of attaching or pasting such minutes to the minute book.

Minutes of each meeting should contain a fair and correct summary of proceedings, particularly the details of officers' appointments in all cases. As regards board meetings or committee meetings, the minutes should contain the names of directors present at the meeting as well as the names of directors dissenting from, and consenting to any resolution passed at the meeting. As regards general meetings, the minute book must be kept at the registered office of the company and should be open to inspection of members for at least two hours each day. Members are entitled to have copies of minutes of proceedings of any general meeting within 7 days from the date of request on the payment of 37 paise (six annas) for every one hundred words or part thereof. Contravention of provisions relating to minutes is punishable with fines.

CHAPTER 9

OFFICE ORGANIZATION AND ROUTINES

THE BUSINESS OFFICE

The office is the throbbing centre of the business where all communicating and recording activities find their initiation and termination. Communication in some form or another is to be undertaken in all areas of the business, and it touches all activities of an organization. It is the communication that sets the employees in individual jobs, regulates their flow of work, co-ordinates their efforts, and secures higher and better accomplishments on the part of people. Beyond the enterprise, the communication keeps the business in constant motion through regular dealings with customers, suppliers, financiers, creditors and the community at large. Besides the generalized form of correspondence, the communication includes a host of other documents and statements like invoices, delivery notes, shipping advice, bills, purchase orders, tenders, quotations, collection memoranda, cash receipts, and many others. Barring the physical production of goods and services, almost all other business activities are dealt with in the office.

The business office is the theatre of management personnel for their guiding, directing, controlling and unifying different affairs or activities of the enterprise towards the realization of some predetermined goals. Managerial efforts are entirely channelled through making and enforcing decisions in the organization. Decision making requires factual information and data of diverse types. For the supply of these facts, figures and statistics, there must be adequate arrangements for keeping the required records, accounts and files. After the decisions are taken, all such decisions are to be communicated for the purpose of their execution or enforcement. No matter where and how a manager is employed in the organization, the management activities of decision making and decision enforcing cannot be carried out without the help of communicating and recording activities. And it is these communicating and recording activities that go by the name of office work. Thus, in the words of Prof. Dicksee, "the office is to a business what the mainspring is to a watch." The office keeps the business ever living, running and thriving through the efficient functioning of management.

ORGANIZATION OF THE OFFICE

As organizing calls for determining total activities, grouping them into separate departments and sections, allocating fixed duties to individuals and delegating authority to different positions, the office comes into being as a result of all such efforts. In organizing the business as a whole, the total business activities are grouped and assigned into purchasing, manufacturing, marketing, financing, personnel, accounting, etc. As all the departments are in need of communicating and recording activities, the provision must be made for the accommodation of sectional offices for each of the departments. Besides these sectional offices required for individual departments, there arises the necessity of organizing a separate office for "general services".

There are certain office activities that tend to serve the requirements of all sectional offices to an equal extent, and such office activities cannot be arranged individually on the part of each department for the sake of economy and efficiency. This common group of office activities is known as *general office services*. General office services include (1) the arrangement of telephone, postal and messenger services for the entire business office, (2) the supply of stationery stores and office forms required by sectional offices, (3) the operation of those costly mechanical equipments which are centralized for the benefit of all sectional offices, (4) the work of centralized typing, shorthand-typing and filing, and (5) the acquisition and maintenance of office furniture as well as the provision of working accommodation for all sectional offices.

The total office activities can thus be divided into two major groups, *viz.*, sectional offices required on the part of each operating department like manufacturing, marketing, finance, accounting, personnel, etc., and the office for general services required for the whole organization. Office management really means managerial efforts directed towards the provision of these general office services as well as the planning of procedures and methods for activities of sectional offices. Planning of procedures and methods is referred to as the formulation of office systems and routines, and it involves an advisory function on the part of the office manager, not an executive function as in the case of general office services. To avoid misunderstanding, it may be pointed out that all correspondence, typing and filing activities are never included within the category of general office services. A major part of such activities remains assigned at the level of sectional offices.

The efficient operation of a business office is dependent upon a number of factors. *First*, the location and layout of the office are to be determined correctly. *Secondly*, proper systems and routines are to be developed for adding effectiveness to human efforts in office work.

Thirdly, common mechanical equipments are to be used for reducing human monotony and boredom. *Finally*, filing of records is to be effected on their logical classification and placing arrangement for purposes of ready reference.

OFFICE LOCATION AND LAYOUT

The office is generally located in an important financial centre far away from the site of manufacturing operations. Two major considerations in the choice of business offices are the available financial and communication facilities. As cities and large towns become the seat of several banks, financial institutions and insurance companies, and as they provide the facility of inland and foreign communication, such places prove to be the ideal sites for business offices. Furthermore, intercommunication between two enterprises in the same industry or between units of mutually dependent industries is greatly facilitated in city locations. As a matter of fact, business offices are found to be concentrated in a compact area. But the high cost of city areas and the dearth of office spaces therein compel many medium-sized and small concerns to choose some outlying areas as the site for their business offices. Whatever area might be selected for the location of business offices, an easy and direct access to cities must be maintained for utilizing financial and communication facilities.

The layout of an office is to be designed according to the nature and size of the business. The dimension and size of the office vary from case to case. A few square yards may be sufficient for accommodating the office of a small concern, while acres of office space prove to be too small to accommodate the office of a large concern with thousands of its office staff. Usually, there exists a similarity of arrangements in the layout of different offices. The office space is divided into general office for both sectional and general-service offices, private offices for important executives, reception rooms, rest rooms, record rooms and stationery stores. The majority of office personnel are housed in general offices. And important executives requiring reflective thinking and concentration of mind are provided with private or personal offices. However, personal offices tend to be reduced to a minimum in those cases where the total space is not sufficient. Otherwise, they create a great obstruction to lighting and ventilation of the general office. The reception room is arranged to entertain the average number of visitors and is made sufficiently attractive to give a good impression to outsiders. Not only the rest room, but the office as a whole is so arranged that visitors can go round the office with ease and comfort. In the allocation of office space, the provision is to be made for future expansion so that overcrowding, and consequent loss of time may be avoided in the future.

It is also the customary practice with business concerns to provide for a special hall for holding conferences and meetings. Placing of different sectional offices is made on the basis of the flow of work. A circular flow of work in a forward-moving direction has been found to be very economical and effective in the operation of business offices. The office for general services is placed at a central point for providing easy access to all sectional offices.

OFFICE SYSTEMS AND ROUTINES

What are known as office procedures and methods in the U.S.A. are called office systems and routines in the U.K. There is no better substitute for office procedures and methods in the effective performance of office work. Such procedures and methods provide standardized and definite guides to operation by indicating the way in which office activities are to be performed. Procedures deal with a complete task with its all sequential steps involved, while methods focus attention on the operation required in one step of the entire task. Usually, methods are confined to the job of one individual and procedures relate to jobs of a group of persons. As a number of operations constitute a single job, and as a number of jobs are encompassed in a procedure, it is methods study that can determine the correct workload of individual employees, improve their performances, eliminate unnecessary operations, and ensure a co-ordinated teamwork on the part of several employees.

Office work requires numerous forms and documents for making the communicating and recording activities more quick, easy and effective in character. But improved design and format of these documents and records are not practicable without the establishment of correct procedures and methods. By analysis, study and observation, many multiple-copy office forms can be designed for condensing two or more communication into one. For this purpose, the procedures and methods are of great help.

As a guide to operations, the employees are to be made known and familiar with the nature of procedures and methods. In many organizations, the "Manual of Office Procedures" is compiled for the information and guidance of all office personnel. This manual contains specimens of all relevant forms and documents, specifies the steps involved in a particular task, and prescribes the methods to be used for a definite purpose. As procedures are prone to become outdated after a certain period, they require periodical revisions for ensuring their effective contribution towards high work performance. Every office develops its standard procedures and methods for the efficient discharge of office work, and it reviews such procedures and methods

for eliminating unnecessary steps and providing equitable distribution of office workload. In the absence of review, there might be delay and confusion in the performance of some work, and duplication and oversight in the performance of other activities.

Routines as to Correspondence. Correspondence constitutes an important part of total office activities of every enterprise. All sectional offices have to make correspondence for conveying instructions, orders, suggestions, complaints, remittances, and for a thousand other purposes. The work of correspondence is to be suitably organized for maintaining the four essential C's in all communication, *viz.*, clear, correct, complete and concise. To aid this effective operation on the part of different sectional offices, the requisite forms and documents are to be designed by the office for general services.

Correspondence involves a two-way traffic to and from the enterprise. Numerous letters and other communication are to be received and sent daily by different sectional offices. It would be a sheer waste of money and efforts to allow the individual sectional offices to receive and despatch their own communication. For purposes of economy and efficiency, the work of despatching and receiving all communication is entrusted to the office for general services. But it must not be understood that the task of actual correspondence is assumed by the office for general services in all cases. In some commercial concerns like banking, insurance and import and export houses, a central correspondence unit is sometimes organized under the office for general services for making certain standardized and non-technical correspondence. Correspondence is effected by the different sectional offices on the part of most manufacturing concerns to meet their own peculiar problems. The office for general services simply acts as a clearing house in distributing the incoming mails to different sectional offices and in sending the outgoing mails through postal or messenger services.

Routines in regard to correspondence have to do with these inward and outward communication. The inward communication is opened in the presence of an executive to ensure that dates of receipt are put on all such communication, that they are sorted out and entered in a register before their distribution to the sectional offices, and that a special care is taken of all those mails which contain remittances. All outward communication is allowed to pass through the office for general services so that they can be entered in a register with dates of despatching and the value of stamps used in each case. In large business offices, internal messenger services are arranged for distributing and collecting communication from the individual sectional offices at an interval of one hour or even less.

OFFICE MACHINES AND EQUIPMENTS

The office equipments include office furniture and mechanical equipments. The equipments should be of appropriate size and quality and must be convenient for operations. They should be sufficiently uniform so as to maintain the symmetry of the general office arrangement. A careful selection of office equipments adds much to the efficiency of the office. Small concerns for the sake of economy sometimes purchase equipments of poor quality, but it turns out to be a very bad economy. Even a small item like the chair can cause a substantial difference in the quality and quantity of work obtained from an employee. Each item must satisfy the conditions of requisite size and proper convenience.

Innumerable mechanical equipments have been developed to aid office work. The degree of mechanization is absolutely dependent upon the volume of work. The introduction of mechanical equipment may not be followed by an economy in office operation in all cases. The economies of labour-saving mechanical devices are generally offset by their overhead expenses in those cases where they remain mostly idle. Mechanical devices that are in common use may be classified in the following way on the basis of their work :

1. Machines for copying and duplicating, such as Typewriters, Rotary Printing Duplicators, Stencil Duplicators, Gelatine Duplicators and Addressing Machines.
2. Machines for handling correspondence, such as Dictaphone and Ediphone, Franking Machines, Folding Machines, and Sealing Machines.
3. Machines for accounting records, such as Comptometers, Burroughs Adding Machines, Tabulating Machines, Automatic Book-keeping Machines and Invoice or Billing Machines.
4. Machines for handling cash, such as Cash Registers, Coin Changes, Coin Sorters, and Cheque Protectors or Cheque Writing Machines.
5. Machines for inter-communication, such as Telephone, Telewriter and Teleprinter, and Pneumatic Tubes.
6. Machines for recording labour time such as Time Recorders, Key Recorders, Desk Autograph.

Typewriters—Typewriters are so familiar to everyone that they do not require any elaboration to explain the nature and use of these machines. Apart from the noisy typewriters, noiseless typewriters have been designed for their use in private offices of higher executive. Besides these manual typewriters, the electrical typewriters are available for taking as many as twenty to thirty perfect carbon copies. Electrical typewriters go by the name of *Electrical Writing Machines,* and they are used for copying purpose where speed, accuracy and economy are wanted.

Roller Copier—The modern copying machine is the *Roller Copier* which consists of two rollers. Blank sheets of paper are fed between rollers so as to get necessary number of copies of the desired letter. The letter to be copied may be written by hand in copying ink or typed with a copying ribbon, and it is inserted beforehand to obtain the copies therefrom. When this machine is operated by electricity, automatic feeding from a rolled sheet of paper is secured. This rolled paper after copying is cut into required copies by the machine.

Duplicators—Copying machines are used for obtaining a limited number of copies. Where hundreds of copies are required, duplicators are used. These duplicators may be of the flat or rotary type, and they may be operated by hand or by electricity. Several varieties with different modifications and adaptations have been introduced. Basically, they may be gelatine, stencil, spirit or type duplicators. In the gelatine process, the matter to be duplicated is impressed on a gelatine bed with copying ink, and that impression is transferred subsequently to blank sheets of paper. The stencil process is a more improved one where the matter to be duplicated is typed or written on a waxed sheet known as stencil. Facsimile representation of this stencilled sheet is obtained on the copies with the help of copying ink. *Multigraph* is a type duplicator which makes copies up to fifty thousands. Multigraph is a miniature printing machine and involves printing fundamentals in duplicating.

Addressing and Listing Machines—These are used for filling bills, invoices or forms. These are also utilized for preparing wage sheets, monthly statements of accounts, or similiar other purposes. Matters to be copied are embossed on a metal plate for getting facsimile copies like typed letters. Because of their high speed and accuracy, these machines are far superior to typewriters.

Adding and Accounting Machines—As in the case of a typewriter, with the pressing of key boards, different amounts are added up and typed on a sheet of paper by adding machines. Without any monotony and fatigue to the operator, this machine can cast up to 100 figures in one minute. *Comptometer* is a calculating machine which can add, subtract, multiply or divide with great accuracy and rapidity. It may be operated by hand or by electricity. *Tabulating Machines* can tabulate the results from a mass of figures relating to purchases, sales, wages, etc. The design of these machines is composed of three distinct processes : punching, sorting and tabulating. The punching process is concerned with punching holes on cards to represent amounts, quantities or other required data. The punched cards are classified under requisite groups by the second process. The final process results in totalling up the information from the sorted cards and in listing the totals thereof as desired. *Accounting Machines* of various types have

been developed for different accounting work, *e.g.*, ledger posting, invoicing, preparing statements or advice notes, calculating foreign exchange, interest or percentages, recording cash receipts and payments, etc.

Coin Changers and Coin Sorters—These machines can classify coins under different groups from a mixed heap of coins and finally count them. An adapted variety of these machines can give necessary changes to customers out of their tendered amounts. *Cheque Protectors* are used to insure against fraud, and cheques are written very quickly with the help of these machines. The cheques are written in such a manner that they cannot be altered or erased by any means. Cheque writers are also used where hundreds of cheques are to be issued daily.

Electronic Computers—Computers have become the grand office machine for utilizing them as a comprehensive tool of managerial information system. The computers collect data from several sources, store such data in memories, combine new data with others held in store, process the data through computation and finally distribute the required information to different decision points. For centralized handling of information, large-sized enterprises have set up these costly equipments, and they work with startling speed in handling information.

METHODS OF FILING

Filing is the preservation of letters and documents in an orderly manner so that they are readily available for reference purposes. Requirements of filing differ from office to office ; but one basic principle of filing is that business records must be so classified that they are traceable when needed.

Old system—There were three old methods of filing, the use of which could be found in rare cases to-day. *Spike filing* was the most primitive of the three. Under this method, documents were fixed or attached to the projecting spike rod. The file used to rest horizontally and vertically. *Docketing* was the second old method under which papers were folded to a uniform size, and on the top of each paper there was written a brief description of the paper known as docket. The papers were placed in several bundles after classifying them alphabetically. These bundles were allowed to rest in pigeon-holes that were made of a wooden frame. The post office even to-day makes use of these pigeon-holes for the purpose of sorting letters. This system of filing was also too cumbersome to be used nowadays in any office. The third method was known as *Pocket and Box filing.* Under this method, the filing equipment was changed from pigeon-holes to pockets or boxes. Containers with several divisions or pockets were used for keeping papers without having them folded or fastened. Both box and pocket

files offered the advantages of protection to files against dust and damage, because they were not uncovered without a lid like the pigeon-holes. Where boxes were used as containers, the papers were placed in their requisite divisions or chambers of the box.

Modern system of filing—The modern system of filing has been introduced with two aims in view—preservation of the papers and facility of their reference. The methods of filing are based upon two considerations : the manner in which the files are to be classified and the arrangements to be followed in the placement of files in racks. Classification of files may be discussed under the heading of 'basis of filing' and filing arrangements under the title of 'filing equipments'.

Basis of Filing. Parallel to five different bases according to which papers are divided, there have grown up five distinct methods of filing, *viz.*, (1) alphabetical, (2) numerical, (3) chronological, (4) subject, and (5) geographical. Of these different methods of filing, alphabetical and numerical methods are basic in the sense that they are used in all cases for primary or secondary classification of papers. Other methods may be regarded as subsidiary ones, because they are not complete in themselves without the support of alphabetical or numerical method.

Alphabetical filing—Under this method, papers are arranged in the alphabetical order according to customers' names or topics of the papers. Correspondence received from a customer and replies thereto are placed in the file together so that the reference is facilitated. Because of its simplicity, this system of filing is exclusively followed by small concerns. But it cannot singularly meet the requirements of a large concern. Surnames of the customers provide a guide for classifying papers with the help of the alphabet from A to Z. The first letter of the surname provides the guide to filing. Where the first letters of several surnames are common, a refinement can be made with the help of the second letter of the surname. For example, papers are received from Mr. Samanta, Mr. Sen, Mr. Sharma and Mr. Shukla ; these papers will be placed in the same file according to the order of names shown in the illustration. Correspondence with Shukla can be traced in the bottom of the file, and the record clerk will not be required to search all papers of the file. In other words, surnames are arranged according to the dictionary order of words. When surnames are identical in several cases, phone directory order of names is followed with reference to the first name or Christian name. The alphabetical method is capable of self-indexing and does not require any separate guide cards.

Numerical filing—Under the numerical method, each customer or subject is assigned a particular number, and all papers pertaining to an individual customer or subject are placed in the same file. Files containing papers are placed in filing racks or cabinets in the numerical

order along with a division of such numbers into groups of 10, 20, 50 or even 100. This grouping is effected with the help of guide cards projected upright in the cabinet drawers for facilitating prompt and easy location of files. To meet the needs of varying circumstances, the numerical method can be refined by way of adopting decimal numbers, as followed in the case of arranging books in libraries. Under the decimal arrangement, files are assigned certain whole numbers like 1, 5, 7 or 18 and papers within a particular file are allotted some decimal fractions like .1, .5, .7, .18, etc. Numerical method of classifying papers is simple in nature and becomes intelligible to all. In contrast to the alphabetical method, any number of papers can be accommodated and all types of papers lend themselves to classification under this method. But it requires a separate index for reference purpose. To get the best features of both alphabetical and numerical methods, a combined *alpha-numerical method* has been evolved under which primary classification is done by alphabet and secondary classification by numbers.

Chronological filing—The papers may be placed in the file according to the order of their dates, the latest being on the top of the file. Where dates of the documents are of prime importance as in the case of bills, reports or returns, this method can be advantageously adopted. When hundreds of documents are received daily, the chronological order may be combined with alphabetical method to get a better result. But this basis is not satisfactory so far as general papers are concerned.

Subject filing—When the subject-matter of papers is deemed more important than the name of the customer or the date of papers, files are opened on this basis. The subject method of filing can be profitably adopted by a concern which may classify its papers into well-defined groups. This method requires special care with which topic-headings and sub-headings of the subject-matter are to be chosen. In some cases, it becomes a difficult job to maintain a logical classification of topic headings which may appear countless. Whenever this method is adopted, cross-references become unavoidable inasmuch as some papers will relate to more than one subject.

Geographical filing—Under the geographical method, the regional area is selected as the basis of filing. The total area may be divided in several ways, such as districts, states, towns, etc. After the first sorting of papers on an area basis, documents are filed under alphabetical or other methods. Publishing concerns, insurance and banking companies and mail-order houses find this method advantageous to them. Large concerns having several branches adopt this method of filing so as to assess the results of each branch separately. The only difficulty of this method lies in respect of those papers which are received from the same person from two different places.

Filing Equipments. In order to preserve the documents over a period, they are required to be kept in some container. The available file containers belong to the group of either horizontal or vertical ones.

Flat or Horizontal equipments—According to these equipments, the files are kept on the loose-sheet system as well as on the lever-arch system. The loose-sheet system is an improvement of the system of old box filing. Drawers have been added, as an improvement, to boxes, and springs have been introduced to hold down the papers so that they may not slip away from the drawer. But this system remains basically the same old box files which required a covered box with several hooks on one side to hang down the documents. The improved box file is an adapted variety of drawers. In the lever-arch system, the papers are threaded or tied up on one side with the projecting spikes which appear like arches. These arched spikes can be turned sideways to keep the papers to be filed therein. To facilitate their attachment, papers are punched for having two holes on one side. Under this system, papers can be attached or removed from the file very easily. Both these systems are of the horizontal type, since papers are allowed to rest in the file in a horizontal position.

Vertical equipments—To remove the defects of horizontal equipments, a new type of containers has been developed to keep the papers in a vertical position through their sidewise placing. This type in its simplest form is the cabinet with several drawers ; the drawers can be pulled out to file papers in upright position after putting them in envelopes. Each drawer is fitted with a wooden block or piece of metal for the purpose of holding the filed papers in a compact form. The papers are not, however, placed directly in the drawer ; they are placed in separate folders or packets which are allowed to stand vertically in the drawer. The vertical equipment can be adopted to maintain records based on the methods of alphabetical, numerical or geographical filing. Because of its associated guide cards that are fixed on the folders or envelopes, this type of filing equipment has acquired much popularity for facilitating rapid references to any folder.

Indexing. An index is an indicator or a device by which the required information can be found out from the heaps of files. Filing without a suitable index is completely useless in any large concern. There are three basic types of indexing :

Card index—The card index involves the use of guide cards ; such guide cards are maintained in an alphabetical order and arranged in an easily accessible form. Cards of uniform size like post cards are made out, and key information relating to each paper or document is entered on separate card. The cards stand upright in a shallow drawer with or without a connecting rod running through the punched holes of

the cards at their lower bottom. The cards may be arranged in the drawer according to any one of the five bases of filing.

The card index is the most elastic and the most satisfactory form of index. The first advantage is that new cards can be inserted or old cards can be removed without disturbing the alphabetical order of the cards. Secondly, the alphabetical order of the cards can be combined very easily with geographical or other divisions through the introduction of cards with distinctive colour. As a result of this measure, no time is wasted in hunting for a guide card. Thirdly, card index pertaining to a library catalogue can be kept for indicating both the title of the books and the author of the books through the use of two colour cards. Finally, it can be adapted not only for indexing files, but for maintaining a number of statistical data as well. Moreover, it is capable of infinite expansion. *Kardex* has been developed as a form of card index which places all the cards before the eyes when the tray or drawer is pulled out.

Ordinary book index—It is in a book form containing a separate division for each letter of the alphabet from A to Z. Each name to be indexed is entered in that division which corresponds with the initial letter of the surname.

Vowel index—It is a variant of the ordinary book index and is designed to save time when there may be several cards with the same initial letter of the surname. The section reserved for each letter of the alphabet is divided into five sub-sections for the vowels (*a, e, i, o* and *u*). The name to be indexed is regulated first by the initial letter of the surname, and then by the vowel of the name which comes first after the initial.

SELECT QUESTIONS

(*More important questions are marked with asterisk.*)

CHAPTER 6 : COMPANY MANAGEMENT AND BOARD OF DIRECTORS

1. The golden rule of capitalism requires that "where the risk lies, there the control lies also". Do you think that the above rule is observed in all widely owned public limited companies?

*2. What are the causes of separation between ownership and management in widely held public limited companies?

*3. Do you think that the Companies Act. 1956 safeguards the interests of shareholders more than the old Act? If so, mention any six points in support of your answer.

*4. Explain how the Companies Act has curbed the rights and powers of top management personnel to remove the evils and malpractices of company management.

5. Briefly indicate the measures adopted in the Companies Act for increasing shareholders' control over the working of companies, on the one hand and for curbing managerial rights and powers, on the other.

*6. What is the true position of directors in the company set-up? In view of their position, state the important statutory and executive powers of the directors.

7. Indicate briefly the liabilities of directors under the Companies Act, 1956.

8. Write notes on—(a) Qualification Shares, (b) Directors Retiring by Rotation, (c) Alternate and Casual Directors, (d) Board Meetings, and (e) Register of Directors' Shareholdings.

*9. Why does the board of directors require a chief executive to assist it in managing the company? Suggest some organizational practices by which the effectiveness of the board can be increased.

10. Where the board of directors delegates its day-to-day powers of company management to the chief executive, what becomes the role of directors in managing the business?

CHAPTER 7 : COMPANY MANAGEMENT AND THE CHIEF EXECUTIVE

11. Explain the nature and importance of the executive committees of directors and managing directors as the chief executive.

*12. Discuss the past role of managing agents in the industrial development of the country.

*13. Discuss the reasons for the abolition of the managing agency system.

CHAPTER 8 : SECRETARIAL PRACTICE AND COMPANY PROCEDURES

14. Discuss the duties and responsibilities of a company secretary.

15. State the chief differences between shares and stocks. Explain the main classes into which shares are divided.

*16. Discuss the significance of no-par shares. What are the advantages and disadvantages of no-par shares?

17. What are the different types of debentures? State the important points of distinction between shares and debentures.

* 18. Discuss the different methods of marketing industrial securities in India. Indicate how far underwriting method is resorted to at the present time.

19. What is a share warrant to bearer and what are the restrictions on the issue of share warrants? Briefly indicate the differences between the share certificate and the share warrant.

20. What is an annual return? What are its contents?

21. Mention and explain briefly the main purpose of the various meetings of shareholders of a limited company.

*22. What are the powers and duties of a chairman, particularly with regard to keeping order in the meeting?

23. Indicate the different types of resolutions and state for what business each is used.

24. Mention the statutory provisions for recording and maintaining minutes of shareholders' and directors' meetings.

25. Write notes on—(a) Right Shares, (b) Bonus Shares, (c) Commission on Securities, (d) Blank Transfer, (e) Statutory Books, (f) Quorum, and (g) Poll.

Chapter 9 : Office Organization and Routines

*26. State the practice of organizing a business office. What are the considerations involved in determining location and layout of a business office?

27. Explain the importance of office systems and routines for making the communicating and recording activities in the office more effective and satisfactory. Outline an effective routine for handling mails.

*28. Discuss the various methods of filing and indexing.

29. Describe the nature of four mechanical devices to be found in a modern business office.

PART FOUR—BUSINESS COMBINATIONS

CHAPTER 10

BUSINESS EXPANSION AND SIZE OF UNITS

EXPANSION OF BUSINESS

The present age has witnessed the establishment of giant enterprises with far-flung activities. Constant endeavour to eliminate waste and inefficiency has brought about in its wake certain technical developments which are responsible for gradual expansion of the size of business units. Under the existing conditions of competitive economy, any established enterprise may expect to grow in size with the enlargement of market for its products or services. This expansion or growth in the size of business unit can be effected in two different ways—(i) internal expansion and (ii) external expansion. Expansion that results solely from gradual increase in the scale of business and resources of the original enterprise may be called internal expansion. In contrast to the growth from within, a business may grow in size by drawing together several existing units of smaller size into its fold. This enlargement in size is called external expansion or expansion by combination.

Discussion of the size of business unit is typified by drawing a line of demarcation between a plant and a firm. Plant refers to an industrial establishment that is either a factory, a workshop or a retail shop concerned with the operational aspect of business. Firm on the other hand, is used to mean a group of establishments or a collection of several plants under some form of common control and management. The firm corresponds to our external expansion or combination of business enterprises. But this may not be the case in all circumstances. Many cotton textile mills in India have set up two or more factories through internal expansion. Consequently, a firm may be the result of either internal expansion or external expansion. Leaving aside the question whether a particular enterprise is a plant or a firm, we may conveniently study the size of business units from the expansion approach—internal expansion and external expansion.

Internal Expansion. All establishments tend to grow towards that size which will give the maximum efficiency of production. That is, the expansion is desirable to the point which is profitable for the business to do so. Within this upper limit, there is a constant urge to expand the

individual unit. The economies of large-scale production can be secured largely by an enterprise through the effective co-ordination of men, machines and materials. These economies include, for example, the use of highly specialized machines for the production of goods, the elimination of costs and expenses due to the adjustment of machines for different processes of production, and the specialization of executives and workers in various tasks. All these economies are known as "technical economies" which are mostly reaped by an establishment outside the jurisdiction of combinations.

Internal expansion is continued to obtain the advantages of quantity production. Except for the capacity of the entrepreneur, limits to internal expansion are determined by the nature of the industry, nature of product and the character of the market. Business units are likely to be large in those cases (*a*) where products and processes can be standardized, (*b*) where manufacturing operations are repetitive in character, (*c*) where products are sold in an extensive market which can be developed by selling efforts, and (*d*) where production requires a huge amount of fixed-capital expenditure. On the other hand, business units will be of small size when products cannot be standardized, the market is narrow in extent, marketing involves a higher transportation cost, products are quickly perishable, and production cannot be mechanised.

External Expansion. Virtually all giant concerns are the direct outcome of combinations with other enterprises. The gigantic size of a business is achieved rarely by the gradual growth of the enterprise from a small beginning. Frequently, giant businesses are formed by drawing together the resources and activities of several existing enterprises so as to be recognized either as new *de jure* or *de facto* enterprises. The purpose in all cases is to secure a greater profit through the economies in production, management, finance and marketing. With a command over vast resources and materials, they attempt at controlling the market, stabilizing prices, and dictating the types of products that the consumer should purchase.

CAUSES OF COMBINATIONS

Combinations are the result of a variety of causes. The basic economic cause lies in the desire to swell, enlarge or stabilize profits. The profits of an enterprise can be increased either by reducing costs or by increasing prices, or by doing both. Hence, the causes of combination fall under two groups : (*a*) some which are meant for reducing costs, and (*b*) others directed to enhance the selling price. Besides the economic factors, there are some non-economic factors that also

influence the formation of combinations. The causes of combination may, however, be stated as follows :

1. *Avoidance of destructive competition*—Business enterprises are tempted to increase their scale of operations during periods of good business. When a period of recession follows, they find the market to be too narrow for their products. Establishments with heavy investments of fixed capital cannot reduce their production suddenly on account of fixed overhead burdens. In order to dispose of their products in a competitive market, prices are often reduced below costs of production and hence competition becomes cut-throat in character. Combination is the natural way out of that desperate situation.

2. *Control of market*—Contrary to the defensive motive stated above, combinations may be formed with an aggressive design. A good many combinations have been planned with the object of deriving monopoly profit by controlling the market. Combinations are formed for exploiting the market, specially in industries where economies of large-scale production are available. With the production of goods on a mass scale, the unit cost comes down to a very low level.

3. *Benefits of large-scale organization*—The combination of business units results in the elimination of duplicate plants, equipments or marketing facilities. One large plant may replace several less efficient ones ; advertising can be directed for creating new markets instead of snatching business from their competitors. Briefly, competition is suspended by combination, and one self-contained and powerful organization emerges to take over the business of competing units.

4. *Acquisition of strength*—To ward off the attack of a well-organized competitor, small producers in the same line of business may be forced to unite their enterprises under single control for enabling themselves to bargain on an equal footing. The increasing importance of fixed capital has accelerated this tendency.

5. *Unification of research, patents and experience*—When business units combine, they can pool their trade-secrets, patents and other business experiences to the common benefit of the group. Development of research is facilitated by collective efforts of the group. Moreover, products can be standardized within a narrow range through the destruction of less important patent-rights and the reduction in the variety of goods.

6. *High protective tariff*—Tariff is said to be mother of all combinations. The practice of levying high tariff has led to the development of combinations among home producers. In order to retain the benefits of protected home market intact, combinations are formed for the purpose of presenting a united front against the removal of such protective tariff.

7. *Development of modern transport and company form*—The

development of company organization has facilitated the growth of large combines. Through the centralized management principle of the company, control over a large number of enterprises can be readily secured. The mammoth size of giant enterprises is a direct offshoot of organizing principles. As regards the contribution of transport, mass production is now matched by mass selling techniques. This mass selling has been made possible by the development of improved transport facilities. Further, concessional transport rates to the large producers have also fostered the growth of some combines.

8. *Influences of finance and promotion*—Many combinations have been formed by promoters and financiers on their own initiatives, when they have found opportunities for large profits in promoting or financing those enterprises. In some cases, personal ambition of promoters for greater power and prestige has induced the independent units to come together under one organization. Besides the cult of the colossal on the part of promoters, the financial institutions have compelled their client concerns to eliminate competition in some cases for improving their financial position.

9. *Other causes*—Sometimes, combinations have been formed under the pressure from the Government or the financial institutions. Scarcity of mineral or natural resources has encouraged the combination movement in other cases.

ADVANTAGES AND EVILS OF COMBINATIONS

Advantages.—Combinations derive many advantages, some of which are available to any large-scale producer but others are within the reach of a combination only. The advantages of combinations may be briefly stated under the following heads :

A. *From purchasing materials*—(*i*) Assurance of steady supply of quality materials, (*ii*) centralization of purchases by expert staff and avoidance of duplication, (*iii*) bulk purchases on favourable terms, (*iv*) smaller size of stock due to the possibility of getting supply from other plants.

B. *From manufacturing*—(*i*) Specialization in production by different plants, (*ii*) standardization of products, (*iii*) elimination of weaker plants, (*iv*) pooling of patents, (*v*) manufacture of by-products from wastes.

C. *From management*—(*i*) Pooling of knowledge and experience, (*ii*) specialized and expert management, (*iii*) reduction in total management costs.

D. *From selling*—(*i*) Saving in delivery expenses because of the supply of goods from the nearest plant, (*ii*) avoidance of cross-freight, (*iii*) unification of sales forces, (*iv*) development of export trade, (*v*) joint advertising.

E. *From financing*—(*i*) Better credit facilities, (*ii*) cheaper cost of financing, (*iii*) facility of raising additional capital, (*iv*) financial stability arising out of increased reserves.

F. *From monopolistic combination*—(*i*) Greater co-ordination between demand and supply, (*ii*) reduced advertising cost, (*iii*) smaller variety of goods, (*iv*) better bargaining powers with labourers and suppliers.

Evils. Evils which are associated with combinations may be stated as follows :

1. *Rise of monopoly power*—Although monopoly and combination do not necessarily mean the same thing, yet they are inseparably connected with each other. There cannot be any denial of the fact that combination generally culminates in monopoly. In spite of the numerous economies, the products may sell dearer than under a state of free competition. The lust for monopoly profits often outweighs all other considerations, and as a result, the consumers, labourers and suppliers—all may be exploited.

2. *Concentration of wealth*—Combinations encourage further concentration of wealth in the hands of a few persons, and they are responsible for the impoverishment of the general mass of people.

3. *Political corruption*—Combinations may exert a corrupt influence on the body politic. Having vast resources at their command, they often bribe the legislators and judges for passing laws and deciding cases in their favour. Government officials are often bribed for consenting to the violation of labour laws and other regulatory measures of the State.

4. *Over-capitalization and speculation*—The economies of combinations may be neutralized by the effects of over-capitalization. Combinations are very susceptible to over-capitalization which may lead to their ultimate ruin. Top-management executives frequently indulge in wild speculation in shares Over-capitalization and speculation are the inherent evils associated with large combinations.

5. *Management difficulty*—Combinations sometimes assume such a gigantic size that efficient management becomes an increasingly difficult task. The dearth of a suitable manager may cause the collapse of a combine.

6. *Stagnation*—Introduction of several grades of management executives usually reduces initiative and incentive for work. Furthermore, absence of potential competition in a giant combination makes the enterprise inefficient and stagnant in character.

LIMITS TO THE EXPANSION

Limitations to the combination movement may be of two types—economic and legal.

Economic. From the economic standpoint, the expansion should be continued as long as the profits derived from growth justify it, and

the rate of return on investment does not fall. But increase in size and increase in profitability are not necessarily related problems, and they do not go hand in hand for ever.

According to E. A. G. Robinson, the business enterprise will expand up to the "Optimum Size" which would give the lowest average cost of production per unit under existing conditions of technique and organizing ability. The forces which determine this optimum size have been classified by him under five groups, *viz.*, technical forces, managerial forces, financial forces, marketing forces, and the forces of risks and fluctuations. There is an optimum unit corresponding to each of these five sets of forces, and the final size of a business unit is the outcome of the reconciliation of different optima. In other words, advantages of one optimum are to be set off against disadvantages accruing from another optimum. The ultimate resulting optimum size of the business is what would give the greatest economies. Balancing of different optima is necessary because of their unequal sizes. For example, the technical ootimum is much smaller than the managerial optimum which, again, lags behind the marketing optimum in size. If expansion is allowed up to the marketing optimum, limits of both managerial optimum and technical optimum are exceeded. Consequently, some diseconomies would appear from the process of expansion. Expansion is only justified in that circumstance when economies of marketing optimum overcome diseconomies of technical and managerial optima.

The concept of optimum size, however, is not a fixed and static one. It is liable to constant variations with the changed conditions of technique, knowledge and organizing ability. It differs from time to time, from place to place within a country, and from one country to another. It is a relative concept suited to the conditions of existing time and place.

Legal. Growth of combination has been checked to some extent by the passing of prohibitory and regulatory laws in different countries. Anti-social activities of monopolistic combinations have compelled the Government in many cases to come to the rescue of the public. Government measures have been directed to disrupt such business in some cases, and to declare a particular form to be an illegal association in other cases. Trusts in America, for example, have been declared illegal. The Kanpur Sugar Syndicate in our country has been closed under orders of the Government.

FACTORS AFFECTING THE SIZE

Expansion of a business unit, whether internal or external, is controlled by the optimum size. Internal expansion is mainly concerned

with the technical optimum, whereas external expansion is related to all of them.

Technical optimum—The technical optimum is the resultant of economies derived from specialization, standardization and mechanization of the processes of production. To secure these technical economies, the size of a business unit is permitted to grow up to the technical optimum. But one peculiarity of this optimum is that it influences the lower limit as opposed to the upper limit of the size. In most industries, there is a fixed minimum size below which production is not economically feasible and this is said to be the minimum technical size. Further economies are not available from expansion beyond the optimum level ; at the same time, it does not give rise to any diseconomy. That is, economies of production remain static from the optimum level upward. Hence, technical forces determine a minimum size, and not the maximum one which is fixed by other forces.

Managerial optimum—It is also the result of economies derived from the management process through division of labour, specialization and standardization. The service cost per unit may be reduced greatly by the employment of specialized and skilled personnel and by the introduction of mechanical equipment in managing business. But unlike technical economies, the diseconomies tend to appear here as soon as management economies are exhausted. The difficulties of co-ordination and supervision beyond a certain stage set the upper limit to the size of the managerial optimum. Moreover, the problem of getting suitable top executives for a complex and large organization may also restrict the size of the business unit.

Financial optimum—The methods of raising capital exercise important influences upon the size of an enterprise in three different ways, namely, (*a*) the cost of raising capital, (*b*) the terms of securing capital, and (*c*) the amount of capital that could be raised. The larger the size, the better will be the facility of raising capital. But this general tendency should be tempered with the character of management that counts much in the raising of capital. Management, as the most vital and living element in any business, may not find difficulty in a particular case to raise the requisite amount of capital on favourable terms despite smaller sizes of the business. Financial forces, thus, do not prescribe either a minimum or a maximum size of the business unit.

Marketing optimum—The size of a business unit is basically controlled by the market for it. The nature of the product, in turn, determines the extent of market. Taking this restrictive condition into consideration, the influence of marketing forces may be discussed upon the size of business units. Expenses on buying raw materials and selling finished goods constitute an important part of the total expenditure of an enterprise and have a considerable effect on the size. A giant concern

can reduce its unit cost appreciably through economies of bulk transactions in several ways. Like the economies of mass production, the mass selling brings similar economies in its consequence. These economies encourage the expansion of business. But when a business continues to grow in size, it is required to spend increasingly heavy sums of money upon sales organization. Consequently, marketing of goods may become more expensive to the business. A stage of expansion may be reached where the extra cost of marketing is not justified by the extra economy to be obtained from operations on a large scale.

Survival optimum—Forces of risks and fluctuations are very potent in fixing the size of an undertaking. If the demand for the goods changes either because of changes in taste on the part of customers or because of changes in the methods of production, the most successful concern will usually be a small-scale one. The more elaborate and complicated the size of the business, the more expensive and difficult it will be to reorganize and readapt the business to the changed conditions. That is, the large business lacks the power of flexibility. Existence of risks and fluctuations in demand dictates, in general, a smaller size. But there is one exception to this general rule. If business conditions are risky, the size of a business is likely to be large. Small units may be forced on account of the risks to combine into one big organization, as in the case of banking and insurance businesses. In other words, the shock-absorbing capacity of an enterprise increases with the expansion of its size.

Conclusion. As pointed out earlier, the optimum size of a business unit is the resultant of interactions among several optima, and it may be something more or something less than a particular optimum. The optimum size of the business unit as a whole, centring round the most economic or profitable size, can be secured by the combination of individual optima in different ways. Accordingly, the optimum size may be found to exist at varying levels of activities. Besides the internal economies which are available to all units, there may exist substantial "external economies" or economies of concentration on the part of some business units. These external economies may transform a business that is otherwise of smaller size into a unit of the optimum size. In other words, the final size is the outcome not only of internal economies like technical, financial, managerial or marketing ones, but of external economies as well. As a matter of fact, there are so many seen and unseen economies available in our country because of the operation of the managing agency system that many enterprises, even being smaller in sizes, are found to conduct their business with as much success as many of their counterparts do in other parts of the business world, both within and without the country. Furthermore, questions

of economies available and economies actually derived involve human relations considerations in business enterprises, and such considerations make the concept of optimum size a theoretical one far removed from realities.

TOO BIG ENTERPRISES

Business enterprises are expanded to derive the full economies of technical forces, managerial forces, financial forces, marketing forces and the forces of risks and fluctuations, on the one hand, and to avoid their diseconomies on the other with a view to maximizing profit and the rate of return on investment. Balancing the individual optima for each of these forces, a resulting optimum for the enterprise as a whole is derived at different levels in accordance with the changing conditions of technique, knowledge and organizing ability. Accordingly, the concept of the optimum or the upper limit to the size of the business is gradually enlarging in many cases. The technological inventions and the managerial innovations are pushing up the size of business to an ever-increasing level.

From the technical side, the greater use of mechanization, standardization and automation has made the size of some industries very large where mass-production is feasible on economic grounds. A size that was considered too big in two or three decades back has become perfectly economical at the presant time. After reaching the full growth from the technical side, attempts have been made from the managerial side for further expansion of the business. From the managerial side, there are two basic patterns of organizing, viz., functionalization and divisionalization. Under functionalization, the activities are classified on the basis of enterprise functions like production, sale, finance, purchasing, accounting, etc. Divisionalization calls for dividing activities on the basis of products manufactured or geographical areas. The size of a business under functionalization is much smaller than the size obtained under divisionalization. What is too big a size under one pattern of organizing may appear as too small under the other pattern.

There are, however, some limits to the expansion in the case of both functionalization and divisionalization. Limits to the expansion are indicated under the following three points :

1. Both under functionalization and divisionalization, the product lines dealt in by a company should be consistent enough so as to create a common bond among them. Urwick has pointed out that it is suicidal for a company to undertake manufacturing of unrelated, inconsistent and odd-lot products for catering to the demands of consumers. The common relationship among many products of the

General Motors in the U.S.A., one of the topmost international giants, has been nicely stated as "a company that designs, builds and sells products based on motors."

2. The growth of functional organization leads to addition of levels after levels. Wherever this layering of the structure would choke the flow of two-way communication and impede the tasks of co-ordination, supervision and motivation, further expansion is not justified.

3. Under divisionalization, there exist a number of autonomous and self-sufficient divisional units which are the real operating units. For guiding, directing and regulating the divisional units, a chief executive team is constituted at the top. The organizing technique of divisionalization calls for maintaining a direct and close link between the chief executive team and the divisional managers. Wherever direct links cannot be maintained and an additional level is introduced between them, further expansion is not warranted.

SIZE OF INDUSTRIAL UNITS IN INDIA

Size is a quantitative term and involves measurement in one way or another. For measuring sizes, there must be some measuring rods or yardsticks without which no measurement is possible. Industrial units being a complex of several factors like materials, men, money and machines for the production of goods and services, measurement of their sizes can be made through the medium of each productive factor or of the product itself. As products are the aggregate result of putting all factors into operation, the products provide a better measuring standard than the factors of production in many cases.

Utilizing the factors of production, sizes can be measured by the amount of raw materials consumed, the number of persons employed, the amount of capital investments made, the plant capacity installed or the quantity of power used for running machines. Coming to products, the sizes can be measured by the volume of products as well as by the value of products. But there are so many varying products and differing uses of productive factors that one standard of measurement often fails to yield satisfactory results. In fact, two or more standards are jointly used in many cases for measuring the size of industrial units. As for example, small-sized industrial units in our country were defined before March 1967 as those concerns which had capital investments not exceeding Rs. 5 lakhs and which employed less than 50 persons with the aid of mechanical/electrical power or 100 persons without the aid of such power.

Large Industries. The average size of units in some industries is stated as follows :

Cotton textile industry—The manufacturing process of cotton mills requires conditioning or converting of one principal raw material into finished products without any addition or separation of materials in its production. Moreover, products are of diversified types for catering to the needs of consumers' fashion or taste. For these reasons, the technical optimum size is comparatively small in the case of this industry. But to secure the economies available from other optima, the sizes of cotton mills in some centres of the country have been increased beyond the technical optimum, particularly when no diseconomies result from the technical side in such expansion. As a consequence, cotton mills of different sizes are operating in the country. The Bombay mills are of the largest size and have spindles between 30 and 60 thousands with the number of looms varying from 750 to 1500. The Ahmedabad mills are medium-sized concerns with spindles from 15 to 30 thousands and loomage capacity of 400 to 600. In the rest of the country, small units operate with spindles varying from 10 to 15 thousands and looms from 200 to 400. An official team has recently suggested that cotton mills with twelve thousand spindles should be regarded as the absolute minimum size and the spindleage capacity of every mill should be ultimately raised to 25 thousand spindles. The National Textile Corporation which was set up in the public sector in April 1968 was supervising the functioning of 103 sick and uneconomic mills at the end of June 1973.

Jute textile industry—In their manufacturing operations, the jute mills are identical with cotton mills and require a small technical optimum size for economical production. The jute industry, being almost entirely concentrated in West Bengal and controlled by some leading industrial houses, makes for larger sizes of its units than those prevailing in the U.K. The stronger marketing and managerial forces have pulled up the level of technical optimum to such a height that uneconomic size did not appear before 1950 as a problem in the case of jute mills. On the contrary, their excess capacity had to be kept sealed for want of market demands. As a result of serious competition from jute substitutes and the growth of jute mills in Pakistan and continental countries, some of the smaller jute mills have appeared as uneconomic units in recent years. During the Second Plan period, about four thousand looms of a few uneconomic units were closed down and their loom-hours were transferred to other units. In West Bengal, jute mills have an average productive capacity varying from 500 to 1400 looms, while a limited few jute mills in other parts of the country have looms numbering less than 500 each.

Cement industry—The manufacturing process of cement factories involves synthetic processing for the transformation of materials like limestone and gypsum into finished products, and the large size of

units brings many technical economies in its wake. As the cement industry is dominated by the A.C.C. (Associated Cement Companies), Sahu Jain and the Dalmia groups, the technical optimum sizes have been exceeded in most cases for securing the marketing, managerial and financial economies in full. Of the total installed capacity of 12.9 million tonnes by 43 factories in 1968, the A.C.C. accounted for 5 million tonnes and Sahu Jains and Dalmias 2 million tonnes each. On the part of all units, a steady growth in their sizes is to be witnessed from the expansion programme. Five units of the A.C.C. raised their capacity to over 4,50,000 tonnes each, and the rest to a capacity of nearly 2,00,000 tonnes each. Similarly, two giant concerns of the Dalmia-Jain group were built through the expansion of their capacity from 1,65,000 tonnes each to 7,00,000 tonnes each. That is to say, the average size has been raised from 1.5 lakh tonnes in 1950-51 to 2.5 lakh tonnes in 1960-61. The installed capacity of the industry increased from 12.9 million tonnes in 1968 to 19.8 million tonnes in 1972 and to 21 million tonnes by the end of the Fourth Plan. Additional capacity of 8.5 million tonnes has already been sanctioned and a further capacity of 5.7 million tonnes is proposed to be sanctioned. In the public sector, the Cement Corporation of India proposes to establish several units for augmenting cement production.

Sugar industry—The sugar industry involves analytical processing in its manufacturing, and large-sized sugar factories can be established for deriving the full technical economies of production. But the size of sugar factories is largely conditioned by the availability of sugarcane in the neighbouring regions. As sugarcanes lose their value and sucrose content by their carrying from long distances, an adequate and nearby supply of sugarcanes is absolutely essential for making the size of sugar factories as large as desirable. Under the existing conditions of the country, the Planning Commission has indicated that a sugar factory with a crushing capacity of 1,000 tonnes of sugarcane per day may be regarded as an economic unit. Judged from this standard, 31 sugar factories out of 143 factories operating in 1955-56 had capacities below the economic level. Adequate measures have been taken in the subsequent period for raising their capacities to economic levels as well as for expanding other concerns. Through a steady expansion of old concerns and the establishment of new factories, it was possible to reach the production targets of 39 lakh tonnes in 1972-73 from a capacity of 35.5 lakh tonnes in 1968-69.

Coal industry—It is an extractive industry, not a manufacturing one. Hence, the gifts of nature are an important consideration to the efficient operation of coal mines. Fortunately for us, nature is not niggardly in depositing good quality coal with suitable thickness of seams and regional concentration. Besides the contributions of nature,

there are cutting, raising, loading and carrying operations involved in the working of coal industry. To make use of mechanical aids in these operations, the collieries must be of certain minimum sizes. But the majority of collieries in the most important coal-producing areas of the country, *viz.*, Jharia and Ranigunge, were of small and uneconomic sizes, and as such they could not adopt mechanical aids in operating their collieries. The questions of eliminating these small-sized collieries were in the active consideration of the Government for a long time. At last, the Government took over the control of 214 coking coal mines and 12 coke oven plants in 1972 under the management of Bharat Coking Coal Limited. The take-over of non-coking coal mines also was effected in January 1973, thus bringing the entire coal industry under Government control. The demand for coal at the end of the Fifth Plan has been estimated at 143 million tonnes. The Coal Mines Authority Limited (CMAL) was set up as a holding company in the public sector in June 1973 for exercising overall control over the coal industry.

Iron and steel industry—The production of pig-iron and finished steel was confined to private sector units before the establishment of three new plants in the public sector. With Government assistance, the capacity of private sector concerns was expanded from 1.43 million tonnes of ingot steel in 1955-56 to 3.0 million tonnes in 1960-61. The four steel plants in the public sector, established in Rourkela, Bhilai, Durgapur, and Bokaro had the initial capacity of one million tonnes each. To raise the productive capacity of these plants further, an expansion programme has been taken in hand. To reach the steel target of 16 million tonnes of ingots set for the Fifth Plan, Bhilai is expected to raise capacity from 2.5 to 4.0 million tonnes and Bokaro from 1.7 to 4.0 million tonnes. The capacity of IISCO and TISCO is also proposed to be raised to 2.5 million tonnes and 4.5 million tonnes respectively. The new steel plants at Visakhapatnam in Andhra Pradesh and Vijaynagar in Mysore are being designed for a capacity of 2.7 million tonnes each. The Steel Authority of India Ltd. (SAIL) has been set up as a holding company in January 1973 for steel and associated industries in the public sector. Its subsidiaries include Hindustan Steel Ltd., Bokaro Steel Ltd., Salem Steel Ltd., National Mineral Development Corporation, Bharat Coking Coal Ltd., Hindustan Steel Works Construction Ltd., Manganese Ores Ltd. and Bolani Ores Ltd.

Small Industries as Ancillaries to Large Industries. The small industries mean those manufacturing or processing units which have capital investments not exceeding Rs. 7.5 lakhs. In the case of certain ancillary industries, the limit of capital investments has been extended

to Rs. 10 lakhs. Before going into the discussion on the relationship between small and large industries, we should enquire about the role of small industries in the Indian economy. The Ford Foundation Committee has pointed out in 1963 in its report that 36,400 small registered factories in India gave employment to more than 13 lakh persons and produced goods of the value of Rs. 1,230 crores during the year 1960. Comparing the position of small industries with that of large industries, it has been stated in the report that small industries utilizing 17 per cent of the fixed capital produced 33 per cent of the gross output and provided 38 per cent of employment of all the registered factories in India.

The small industries occupy a prominent place not only in the backward economy like India, but they are also equally important in the advanced countries like the U.S.A., the U.K. and Japan. Small industries account for 92.5 per cent of business establishments, 45 per cent of workers and 34 per cent of industrial output in the U.S.A. Likewise, they account for 29 per cent of industrial employment and 19 per cent of production of all industries in the U.K. In Japan, small industries occupy a predominant place in the industrial economy and they contribute 84 per cent of employment, 56 per cent of output and 52 per cent of the country's exports.

In a developing country like India, there are many reasons for fostering the growth of small industries. The reasons include the following: (*a*) Small industries being labour intensive in character, they can solve unemployment problem in a shorter period. (*b*) They help in securing regional distribution of industries. (*c*) They require smaller capital investments and lesser foreign exchange resources for achieving results. (*d*) They ensure rapid return on capital investments. (*e*) They require for their establishment a smaller amount of social cost. (*f*) They enjoy greater flexibility as to methods of production and market conditions. (*g*) They aid to the removal of poverty and inequality in income among people.

As in other countries, small industries should be allowed to complement the large industries by way of operations through sub-contracting and service. By working as feeders or ancillaries to large industries, the small industries can meet the requirements of many parts and components needed by large units in manufacturing bicycles, motor vehicles, typewriters, sewing machines, agricultural implements, etc. Both sides are equally benefited by this co-operation and mutual help. Large industries are relieved from the burden of making too much capital investments and unnecessary blocking of capital on machines and tools required for producing varied parts. As per design supplied by them, large industries can secure quality parts at a cheaper cost. On the other hand, the small industries are assured

of a ready market for their parts and they can concentrate on the production of such items for keeping down cost.

The Government of India is now trying to secure collaboration between large and small industries in the country. With this end in view, 3,000 large industrial units have been asked to indicate the extent to which they can farm out manufacturing of their components to small industries. There has been a rapid growth of small industries in India during the last decade. The number of small registered factories has increased from 36,000 in 1962 to 1,40,000 in 1969. The value of purchases by the Central Government Departments from small industries increased from Rs. 6.5 crores in 1960-61 to Rs. 28.6 crores in 1968-69.

Biggest Companies in India. The Economic Times, Bombay, in its analysis on 11th January 1965 has ascertained the biggest companies in the private sector (excluding private limited companies, banks and insurance companies and other financial institutions) from the standpoints of total assets and sales income of such companies.

From the standpoints of total assets as well as sales income as on 31 March, 1964, the position is indicated by the following two tables :

TABLE I

Rank	Name of Companies	Total Assets minus Depreciation (*Assets in crores of rupees*)
1.	Tata Iron & Steel Co. Ltd.	159.2
2.	Indian Iron & Steel Co. Ltd.	99.9
3.	Tata Engineering & Locomotive Co. Ltd.	56.8
4.	Associated Cement Companies Ltd.	55.8
5.	Scindia Steam Navigation Co. Ltd.	43.3
6.	Delhi Cloth & General Mills Co. Ltd.	36.9
7.	Burma-Shell Refineries Ltd.	36.4
8.	Imperial Tobacco Co. of India Ltd.	29.2
9.	Premier Automobiles Co. Ltd.	26.8
10.	Esso Standard Eastern, Inc.	26.4

TABLE II

Rank	Name of Companies	Sales Income (*In crores of rupees*)
1.	Tata Iron & Steel Co. Ltd.	110.4
2.	Indian Iron & Steel Co. Ltd.	76.0
3.	Hindustan Lever Ltd.	59.5
4.	Imperial Tobacco Co. of India Ltd.	55.4
5.	Tata Engineering & Locomotive Co. Ltd.	51.0
6.	Associated Cement Companies Ltd.	47.2
7.	Delhi Cloth & General Mills, Co. Ltd.	46.8
8.	Esso Standard Eastern, Inc.	42.5
9.	Dunlop Rubber Co. Ltd.	40.7
10.	Hindustan Motors Co. Ltd.	32.6

CHAPTER 11

CLASSIFICATION OF COMBINATION

TYPES OF COMBINATION

Combinations are classified from the approach of their ownership form as well as from the nature of their business activities. Usually, combinations as to the lines of business go by the name of different 'types of integration', and combinations looked at from the side of ownership are called different 'forms of combination'. Integration may be of three types : horizontal, vertical and circular.

Horizontal integration—This combination is effected by enterprises which are engaged in manufacturing like products or rendering like services. It involves the joining of two or more enterprises in substantially the same line of business under one management and control. With the object of controlling the supply of a group of products, similar activities are combined under one agency, and it attempts at the acquisition of monopolistic powers. In our country, the Associated Cement Companies, the defunct Sugar Syndicate, the Indian Jute Mills Association and the Indian Paper Makers' Association furnish examples of this horizontal integration.

Vertical integration—Vertical integrations involve combination of those enterprises which are engaged in different stages of production or processes of manufacture. They combine the activities of two or more enterprises with unlike products or services in such a way that their lines of business become complementary steps in production and sale. The object of this type of integration is to achieve self-sufficiency and to become independent of other concerns for the supply of raw materials, for the fabrication of materials into finished products, or for the marketing of products. Complete integration of all steps makes the combinations an entirely self-contained unit. As opposed to this complete integration, there can be partial integration of some steps either towards the consumer or back towards the raw materials. The Tata Iron and Steel Co. Ltd., which controls the supply of raw materials and undertakes manufacturing may be cited as an example of vertical integration. Combination of spinning and weaving mills in textile industries also involves vertical integration.

Circular integration—It is concerned with the unification of several enterprises that are remotely connected with one another in their production and sale of diverse goods or services. That remote connection may be found between products requiring similar manufacturing pro-

cesses or using the same marketing channels. In other cases, the common link may exist in the supply of auxiliary goods and services or in the joint management of all enterprises. The object of circular integration is to secure the benefits of large-scale operations arising out of industrial co-operation and combination. Business combinations through the medium of a common managing agent in our country illustrate the nature of this circular integration. The British India Corporation explains the character of the circular integration. It was established in 1920 to take over six companies, *viz.*, the Cawnpore Woollen Mills, the Cawnpore Cotton Mills, the New Egerton Woollen Mills, the North West Tannery, Cooper Allen & Co., and the Empire Engineering Company. It purchased in 1947 Begg Sutherland & Co., Ltd., which was controlling 10 concerns. Circular integrations are sometimes divided into lateral (or allied) integrations and diagonal (or services) integrations.

Some combinations are formed without any adherence to these principles, and as a result, they may not fall under any one of the three types. As a matter of fact, all large combinations involve partly horizontal, partly vertical, as well as partly circular integration. That is, these different types of integration are not mutually exclusive to one another ; and for purposes of discussion, they are treated as distinct types of integration.

Relative Merits and Demerits. The primary object of horizontal integration is to eliminate competition. The combining units can reduce their production, fix uniform prices, effect common selling, and make some other adjustments to do away with the evils of competition. Moreover, they derive some economies in production and management. But they may find considerable difficulty in procuring their raw materials, and the market for their products may not be assured in spite of the combination.

Vertical integrations bring about economies in storage, selling, buying and transportation. They can eliminate the middlemen's profit and are assured of the steady supply of raw materials of uniform quality. Further, products coming from the lower stages of production find a ready market. But one serious difficulty of this integration lies in the risk of putting the entire productive machinery to a dead stop because of dislocations or work stoppages in any one step. Although a vertical integration becomes a self-contained unit, yet it may have to face competition from other units in the disposal of its end product. The economies of large-scale operations are not usually available in the case of vertical integration.

In between horizontal and vertical integrations, the circular integration can secure economies in management, finance, and to some

extent, in marketing. The general economies of large size are within the realm of circular integration.

FORMS OF COMBINATIONS

The study of business houses gives us an account of the formation of many formal and informal varieties of combination. Such forms of combinations differ from one another in the extent of ownership held by the combination over the property of the federating units as well as in the degree of control exercised by the combination over the group. From the standpoint of ownership, different forms of combinations may be regarded as secondary or derivative forms of business, since two or more enterprises orginally established under the primary forms must come together to form a combination. The various forms of combinations that have been developed may be broadly classified as follows :

1. Association—(*a*) trade associations, (*b*) chambers of commerce and industry, and (*c*) informal agreements.
2. Federations—formal agreements: (*a*) pools, and (*b*) cartels.
3. Consolidations—
   A. Partial consolidations—(*a*) trusts, (*b*) holding companies, and (*c*) communities of interests.
   B. Complete consolidations—(*a*) amalgamations, and (*b*) mergers.

ASSOCIATIONS

Trade Associations. The trade association is radically different from all other forms of combinations. Strictly speaking, the trade association is a combination of businessmen, not of their business concerns. It provides facilities to the businessmen engaged in a particular line of business for the promotion of their common interests, the growth of friendly relations, and the exchange of news and views pertaining to their business activities. Unlike other forms in which business activities of two or more concerns are joined together for increasing the amount of profits by way of influencing their production, sales or pricing policies, trade associations do not conduct any business of their own and have no direct objective of profitability in view. Trade associations aim at removing the barriers of isolation between concerns, seek the mutual co-operation of businessmen in solving their common problems, and want to do away with business jealousies and rivalries through securing participation in their joint interests.

That trade associations provide valuable services to their members is evident from their growing numbers in the business world. They deal with matters like industrial relations, public relations, collection and dissemination of business information, credit information, trade promo-

tion, marketing and advertising practices, industrial research, and a host of other activities. In matters of legislation relating to trade and industry, trade associations explain the implications of such measures to their members, and if necessary, raise the united voice of their members against the adoption of the proposed legislation. For the protection of their interests, members of the trade association may put a joint demand for the framing of a new legislation. Briefly, trade associations become the mouthpiece of the businessmen concerning a particular trade or industry.

Trade associations are formed widely in all branches of business with representations from different parts of the country. They may be local, regional or national in character, and again, commercial or industrial in business activities. The East Indian Cotton Association, the Madras Traders' Association and the Calcutta Traders' Association provide illustrations of the commercial type of trade associations. Trade associations of the industrial type include the Indian Jute Mills Association, the Indian Tea Association, the Bombay Millowners' Association, and many others. The number of trade associations formed in the country has been recently estimated at 836. Of these associations, 170 associations have memberships drawn from different trades or industries and they are organized for promoting general interests, while the remaining 666 associations are confined to particular trades or industries and they represent sectional interests.

During the greater part of the nineteenth century, trade associations were only formed by the European merchants. Some of the early European associations include the Association of Indigo Planters (1801), the Calcutta Traders Association (1830), the Madras Traders Association (1856), the Indian Tea Association (1881), the Indian Jute Mills Association (1886), and the Indian Mining Association (1892). The Bombay Millowners' Association was formed in 1875 by the joint efforts of Indian and European businessmen. After the grant of discriminating protection, a number of Indian associations were established in the thirties of the present century. Some of the important associations of the period are the Indian Mining Federation (1930), the Indian Sugar Mills Association (1933), the Indian Colliery Owners' Association (1933), the Indian Soap Makers' Association (1934), the Indian Paper Mills Association (1939), and the All-India Manufacturers' Organization (1941).

Chambers of Commerce. Chambers of commerce are associations of traders, industrialists, banks and some professional men for the promotion of business interests in the locality they serve. The chambers of commerce are voluntary associations in our country and they are usually incorporated bodies formed as guarantee companies. Chambers of com-

merce have been established with membership confined to a particular State or with membership spread throughout the country. The first chamber of commerce was established in Bengal in 1834 by the European merchants. In Bombay and Madras, two other European chambers of commerce were established in 1836. The first Indian chamber of commerce was formed in Coconada in the year 1885, and two years later, the Bengal National Chamber of Commerce was established in Calcutta. At present in all the States and important financial centres of the country, chambers of commerce have been established. In Calcutta, there are five chambers, *viz.*, the Bengal Chamber of Commerce and Industries, the Bengal National Chamber of Commerce and Industries, the Indian Chamber of Commerce, the Bharat Chamber of Commerce, and the Oriental Chamber of Commerce. There are about 15 all-India chambers of commerce. Besides, there are two chambers of commerce of the federal type. The Associated Chamber of Commerce of India, consisting of 15 local chambers, was established in 1920 by the European businessmen. The Indian businessmen have established in 1927 the Federation of Indian Chambers of Commerce and Industry through the affiliation of 24 different chambers of commerce and trade associations in the beginning and now it has membership of 177. Beyond the country, the International Chamber of Commerce has been established in 1920 with representations from all important nations of the world for the purpose of encouraging the free flow of foreign trade.

The chambers of commerce render many services to the benefit of their members as well as to the local community. The important functions of a chamber of commerce include (1) promotion and protection of business interests, (2) collection and dissemination of factual information, trade statistics and market news, (3) opposition to or initiation of legislation, (4) settlement of trade disputes by arbitration, (5) standardization of trade practices and regulation of competition, (6) issuance of certificates of origin to exporters, and (7) the provision of industrial research, market research, technical help, legal assistance, etc.

Informal Agreements. The trade association has acted as a forum for contributing to the growth of many informal agreements among the businessmen. Under the agreements, businessmen promise to restrict their competition in marketing goods or to stop price-cutting of goods through a concerted move on their part. The informal agreement is based upon a verbal promise or tacit agreement which is no more than a mere understanding between the parties to the agreement. Accordingly the validity of the agreement rests on the party's word of honour, and for this reason, the informal agreement is referred to as a gentlemen's agreement. On the refusal of one party to adhere to the terms of the

greatest development of cartels had taken place in Germany where they were encouraged and developed by the Government of the country. A cartel is an association of independent undertakings for entering into a contract to regulate output, to fix quotas, to divide market and to control sales and prices for the purpose of eliminating or limiting competition among themselves. Cartels are usually formed by producers in the same line of business ; and the primary object is to maximize profits by rooting out competition through various restrictive measures. The area of operation becomes very wide in the case of a cartel and it may include all the producers of a particular product in its fold. Starting their career as a loose combination of German producers, cartels extended their activities over the entire globe.

According to the nature of their activities, cartels may take one of the following forms :

a. *Condition cartel*—It fixes certain conditions which are to be observed uniformly by the combining units ; these conditions usually relate to the length of credit, terms of delivery and packing, the rate of trade discount, and other like matters. It is evident that this form of cartel resembles trade associations.
b. *Quality cartel*—It fixes the different grades of the products dealt in by the members along with the prices to be charged for each grade.
c. *Price cartel*—It determines the minimum price below which members should not sell their products. This price maintenance becomes ineffective due to the volume of output remaining uncontrolled.
d. *Output cartel*—The overall production targets are planned by this cartel with the allocation of fixed quotas or shares of production for each member.
e. *Territory or market cartel*—This cartel is organized to divide the market, both national and international, among the members. By this division of the market, competition is avoided, and solidarity of the organization is maintained.
f. *Organized cartel with a selling syndicate*—After experimenting with the above loose forms of cartel, an effective and well-organized form of cartel was evolved in Germany by the formation of participating cartel with selling syndicates. It became so popular that cartels took the alternative name "Syndicate", and all cartels were thereafter organized in that country under this form.

A central selling agency is set up as a separate registered body by the members of the syndicate type of cartels. Interest as well as control

of the selling syndicate is shared by the members in proportion to their fixed quotas of production. Members are required to sell their entire production to the central selling agency at a fixed price based on the average cost of production. Penalty is imposed when a member exceeds quotas, and compensation is arranged if the quota is not reached. The selling syndicate markets the products to consumers at the best obtainable price. Under this arrangement, manufacturing profits are retained by the members individually and trading profits are pooled together by the selling agency to be divided among the members in proportion to their quotas.

Growth of Cartels in Germany. The Cartel as a price-fixing association made its appearance in Germany at about the year 1860, and there were only six cartels at the end of the next ten years. The year 1879 is a landmark in the history of the cartel movement which acquired a new impetus by the famous tariff measure of Chancellor Bismarck. By fits and starts, cartels cropped up in numbers, and during the period from 1885 to 1890, 120 new cartels came into existence. Cartels took the form of syndicates from the year 1890 when many important organizations were set up. The Rhenish Westphalian Coal Syndicate was established in 1893, and the Steel Works Union was formed in 1904. The German Government followed the principle of compulsory cartelization, and the Government had to come to the rescue of cartels whose existence was threatened from time to time. The coal industry was completely cartelized under 11 Coal Syndicates and one Imperial Coal Union by the time of World War I.

During the post-war period, the giant chemical company of I. G. Farben was established in 1925, and in the next year, the largest six steel producers joined together under a new Steel Union. By this period, industries like coal, potash, chemical, and iron and steel were placed under the complete control of cartel organization. And in the case of other important industries, 50% of their output came under the influence of cartels. The second great fillip to the cartel movement was provided by Hitler who utilized the cartels for re-building Germany. The world-famous steel concern "Krupps" was fully utilized during his regime.

A policy of decartelization was adopted at the Peace Conference in 1945, and all the important cartels were dismantled through the establishment of several small concerns. It is reported that German cartels are again re-appearing in West Germany at the present time. Indeed, the German soil is very fertile for the growth of this form of combination, and it would be difficult to induce the German people to give up their association with cartels as a tool of industrialization.

International Combines. (CARTELS). German cartels took a leading part in the formation of many international cartels, and a limited

number of such cartels were initiated by the American or British Companies. The number of international cartels is estimated to have increased from 114 before the World War I to 175 on the eve of the World War II. Under the usual method which is followed by such international organization, home markets are reserved for domestic producers, while foreign markets are divided among the participating members under a quota system of production fixed by the combination. Existence of such cartels is to be found in industries relating to steel, rubber, petroleum, tin, chemicals, rayon and several others. Among the organizations, the European Rail Makers' Association, the Dyestuff Cartel of I. G. Farben, and the International Tin Cartel are worth mentioning. Another organization of holding company type is to be found in the vast Unilever organization which bears testimony to international combines. The Hindustan Lever Ltd., is a subsidiary company of this giant concern. Some other national concerns have extended their activities over the whole world, such as Ivar Kreuger (in the match industry), the Standard Vacuum Oil Company, the General Electric Company and its subsidiary R. C. A., and the Imperial Chemical Industries.

Although international cartels are contended to have grown up as a natural effect of modern economic development, yet they are responsible for four serious evils : (*a*) restriction and suppression of technical developments, (*b*) restriction on the output of products and uneconomic use of resources, (*c*) deterioration in the quality of products and (*d*) assumption of anti-national character in some cases.

COMBINATION TRUSTS (OR TRUSTEE DEVICES)

The original significance of the term "trust" has now been lost, and it is used indiscriminately for any combination of the type of partial or complete consolidation. In the study of different forms, we must know the exact nature of the combination trust or trustee device. The combination trust was evolved by an ingenious attempt in America to apply the prevailing voting trust principle for the purpose of effecting combinations. But that attempt was foiled by the courts on the ground that it amounted to a partnership of companies, since companies could have no authority to enter into such an agreement. Combination trust was given a prompt burial by the American courts when the two pioneer trusts, the Standard Oil Trust and the Sugar Trust, were declared illegal.

Evolution of Trust in America. The combination trust evolved out of the existing business trust and voting trust. To understand the nature of combination trusts, one should be familiar with the business trust and the voting trust. The principle of trusteeship, which is often utilized for managing the property of a deceased person, is also capable of being

extended to business activities. Accordingly, business trusts mean a simple form of organization in which the business is placed in the hands of trustees who manage it as formal owners for the benefit and advantage of real owners, technically known as beneficiaries. On the contrary, the voting trust is a means to gain control in a particular company by its minority group of shareholders who form a board of trustees for the purpose of collecting votes. Under the voting trust, shareholders transfer their shares to the trustees who issue in exchange thereof equivalent trust certificates. These trust certificates show the equitable interest of the members in the assets as well as in the earnings of the company. But the voting right is transferred to the trustees whose names are entered in the company's register of members as legal owners, though such ownership is nominal in character. Under this arrangement, trust certificates are held in place of share certificates ; and share certificates are returnable to the members on the surrender of trust certificates at the end of a certain fixed period. Voting trusts are permitted by the American courts even up to the present time, provided they are formed in good faith for the benefit of the company. Business trust is also a permissible form of organization.

Obviously, the combination trust was only a step further from the voting trust ; it was evolved for the purpose of exercising control over several companies instead of one company, as in the case of voting trust. Under combination trust, shareholders of the combining companies are required to transfer a sufficient number of shares to the trustees so as to assure their control over the companies. The trustees used to elect the directors of all companies and to direct the affairs of such companies through a selected group of common directors. Combination trust pooled the profits into a common fund, out of which distribution was made to the holders of trust certificates. But it kept the identity of individual companies intact without acquiring their assets.

The trustee device was akin somewhat to business trust and to voting trust. It differed from a business trust in respect of its association with more than one concern for the acquisition of voting rights alone, not property of any kind. A holding company can be differentiated from a combination trust in four respects : (*a*) formation of holding company is made by incorporation, and not by a contract as in the case of combination trust, (*b*) holding company is managed by a board of directors rather than by a board of trustees, (*c*) unlike the trust, the holding company is not created for a limited period, and (*d*) there is no exchange of certificates for shares in a holding company.

THE COMMUNITY OF INTERESTS

The community of interest is a unified relationship established be-

tween two or more concerns by virtue of a common dominant ownership or control held by a group of persons. The objective of this form is to secure joint and harmonious working of a number of enterprises. The controlling interest is usually obtained in various ways by a small group of shareholders, and not by an incorporated company as in the case of a holding company. The combined investments of the group enable it to elect the directors and to frame the general policies that are to be followed by the companies. By this arrangement, a *de facto* combination is effected among the enterprises. Briefly, the community of interest implies that controlling interest is held by a community made up of kinship, friendship or some other relationship.

Community of interest has taken three different forms in our country :

1. *Interlocking directorate*—Through the appointment of some common directors in a number of companies, the will of the dominant group is made to prevail over the companies. However, this type of community of interest can be made ineffective to some extent by shutting out the common directors from the executive committee, the finance committee and other standing committees of the board of directors on the part of individual companies. A variant of interlocking directorate can also be found in what is known as multiple directorship. Before the enforcement of the Companies Act, many executives used to hold a large number of directorships in several companies.
2. *Managerial integration*—Company management through the managing agent was a common practice in our country. A number of companies were usually managed by one managing agent which used to establish a community of interest among its managed companies.
3. *Financial integration*—Another application of this community of interest is to be found in the financial integration made both by managing agents and by other financial institutions. When several companies are financially tied down by one agency, virtually a community of interest results in such companies.

Evaluation. The community of interest is open to three criticisms. *First,* it may not be effective in all cases ; and unless it secures complete control over the concerns, economies of large-scale operations cannot be derived. *Secondly,* one company is likely to be exploited by another company in which the dominant group has greater investments. *Thirdly,* community of interest operates from behind the scenes, and as such secrecy surrounds its working. It becomes difficult to prove the existence of this combination and to determine the persons responsible for it. Because the existence of a community of interest can be concealed

through the setting up of dummy directors, it often goes outside the pale of regulations.

The company law does not look upon the community of interest with favour. The Companies Act, for example, has limited the number of directorships to 20. Directors are persons entrusted with solemn responsibilities, and they are to discharge their trustee role in the stewardship of the company. Consequently, the directors who are selected to carry out the desires and whims of the dominant group without exercising their own judgement and wisdom, are likely to become mere puppets in the hands of a community of interest.

HOLDING COMPANIES

The holding company is a separate company and controls policies of other companies through the ownership of their key shares. The Companies Act, as amended in 1960, defines a holding company as 'any company which directly or indirectly through the medium of another company, holds more than half of the equity share capital of other companies or controls the composition of the board of directors of other companies. Moreover, a company becomes a subsidiary of another company in those cases where the preference shareholders of the latter company are allowed more than half of the voting power of the company from a date before the commencement of this Act'.

Holding company organization was devised in America towards the end of the nineteenth century when the combination trust was rooted out of existence through court decisions and legislative enactment. It may be pointed out here that a holding company in America need not always be an incorporated company or corporation, but such a company may also be either a simple business trust or a joint-stock company. The owning or controller company is known as parent company in relation to its controlled companies which are called subsidiaries. Recently, two holding companies have been formed in the public sector in India, *viz.*, the Steel Authority of India Limited (SAIL) and the Coal Mines Authority Limited (CMAL).

Holding companies may be of the following types :

A —According to the Nature of Activities

1. *Pure holding company*—It simply holds the shares of other companies through the investment of its entire resources and does not operate any business of its own.
2. *Operating or mixed holding company*—It is both an operating company and a holding company. It engages in business activities on its own

account over and above the function of exercising control over other companies.

B.—According to Sub-Infeudation

3. *Primary holding company*—There may be several grades of holding companies in a holding company set-up. The apex company standing on the top of the structure is known as the primary holding company.
4. *Intermediate or sub-holding company*—An intermediate holding company in between the primary holding company and the subsidiary companies at the bottom of the structure is called a sub-holding company. It is a holding company under another holding company.

C.—According to the Sequence of Organization

5. *Parent holding company*—When an existing holding company sets up a new subsidiary company with the object of transferring some branches of its business or of getting an investment outlet, the holding company becomes the parent company. That is, it gives birth to one of its subsidiaries.
6. *Consolidated holding company*—Several existing companies are consolidated under a new holding company that is organized for the purpose. That is, in the order of existence or organization, the holding company comes into being after the establishment of subsidiaries.

Advantages. The advantages of holding companies are many, some of which are briefly stated under the following heads :

1. *Facility of formation*—A holding company can be formed with comparatively greater ease than any other form of combinations. No consent of shareholders of either the holding company or the subsidiary company is required for the establishment of this organization. Moreover, it does not face resistance from any quarter, as it retains the separate existence of its subsidiaries and their goodwill.

2. *Economy in operation*—Because of its large size and centralized control, it can effect many operational and administrative economies in respect of finance, management and marketing. A well-integrated and competently managed holding company becomes a tower of strength to the group of companies.

3. *Avoidance of risks*—It can pass off the business risks and experimental risks by undertaking projects through its subsidiaries and withdrawing control from such subsidiaries by selling their shares in a stock market.

4. *Financial pyramiding*—With a relatively small amount of investment, a few persons of the top holding company can secure control over several companies along with their investment running into millions of rupees. Without going into the details of pyramiding technique, it can be said here that a holding company may gain control over another

company through making as small an investment as 10% only. Hence, it provides the most economical means of forming an effective combination.

5. *Preservation of goodwill*—For the purpose of tapping the market widely, it can produce cheaper or inferior products through some of its subsidiaries without endangering the reputation and credit of its own. It can keep the fact concealed as to that certain companies are playthings in its hands. Again, it escapes the public censure or wrath that is associated with any giant undertaking, and thus maintains its goodwill unhurt.

6. *Financial guardianship*—Under the care and control of the holding company, access to the financial market becomes easy for the subsidiary companies. Subsidiaries are assured of timely assistance from the holding company, or they can raise funds from the market at a lower cost. Financial backing of the holding company gives a stamp of financial stability and soundness to companies in the chain.

Disadvantages. 1. *Expensive structure*—All the units of a holding company organization being incorporated companies, it involves a high fixed cost for the maintenance of so many corporate structures with their different expenses and taxes.

2. *Complexity of structure*—The temptation for extending control is so great in a holding company that it often makes the structure too complex by expansion to manage properly. As a result, inefficiency creeps into the organization which becomes a cobweb of frauds, manipulations and abuses.

3. *Financial juggling*—The greed for expansion induces the holding company to collect heavy amounts with fixed interests thereon. Consequently, the debt-burdened holding company cannot meet its fixed interest charges in lean years, and it may not be able to withstand any great fluctuation in its earning capacity. In its desperate attempt to save the situation, the holding company adopts certain unfair practices that weaken further the financial solvency of the entire organization.

4. *Misuse of inside information*—It offers endless opportunities for inside manipulations. Top-management executives may require the holding company to re-purchase the proposed property or share from them at higher prices because of prior purchasing of such property or share by them with their advance knowledge. Further, shares of the existing companies in the group can be made subject to wide price fluctuations by varying their rates of dividend ; here again, top executives may find a scope for making big fortunes overnight at the cost of investors.

5. *Exploitation of subsidiaries*—The holding company may waste the assets and destroy the earning capacity of subsidiaries in several

ways : (*a*) it may force the subsidiaries either to give loans to it or to take loans from it on a term always unfavourable for them ; (*b*) it may make an excessive charge for specialized services that are, to say the least, unnecessary for the subsidiaries ; (*c*) it may compel the dependent companies to make unwarranted dividend payments by neglecting the requirements of depreciation and maintenance ; and (*d*) it may divert the funds of one company to another with an utter disregard for the interests of investing companies.

6. *Selfish absentee control*—A holding company with wide ramification usually operates its activities from a large financial centre. This remoteness of control coupled with a narrow selfish outlook of the holding company makes management of subsidiaries ineffective, inefficient, and incompatible with local conditions.

7. *Undesirable concentration of wealth*—It wields great financial powers without any corresponding responsibility, and as a result, it does not fail to utilize the overbalance of powers for achieving its own ends. Public interest is thereby injured (*a*) for its charging high prices from the consumers, (*b*) for corrupting the Government officials, and (*c*) for violating labour laws and other regulations.

Regulation under the Companies Act. The Companies Act requires that every balance sheet of a holding company must be supported by the following documents in regard to each of the subsidiaries : (*a*) a copy of the balance sheet ; (*b*) a copy of the profit & loss account ; (*c*) a copy of the directors' report ; (*d*) a copy of the auditors' report ; (*e*) a statement showing the extent of holding company's interest in subsidiaries and the net amount of profit & loss of subsidiaries at the end of the financial year : (*f*) a statement, in cases of varying accounting years, showing the change in holding company's interest and the change in subsidiaries' assets and borrowing during the intervening period ; (*g*) wherever necessary, a statement of the directors explaining the reasons for their inability to supply the above information.

For wilful contravention of the statutory requirements, a penalty of six months' imprisonment or ten thousand rupees' fine, or both may be imposed in respect of each offence. Further, the accounting year of a subsidiary company should not end earlier than six months from the accounting year of the holding company ; the Central Government can grant exemptions in appropriate cases.

CONSOLIDATIONS

Consolidation is the unification of two or more enterprises with the object of forming a *de jure* business unit. The combining units lose

their separate existence and are brought into a single company. Consolidation can be effected in two different ways, namely, merger and amalgamation. In a merger, one or more companies are fused with another existing company. That is, an existing company absorbs, swallows or purchases outright other company or companies. Amalgamation, on the other hand, means the fusion of two more companies into a new company. Amalgamation involves the formation of a new company for the purpose of taking over the assets of those existing companies which go into voluntary liquidation. It is the setting up of a new company by other existing companies whose identities are missed in the company they form.

In popular parlance, however, there is no difference in the terms consolidation, merger and amalgamation ; and they are used synonymously. But amalgamations differ from mergers in two respects. First, amalgamations are effected frequently on the initiative of an outside promoter, because business rivalry of different concerns acts as a bar to their coming together on their own initiative. Mergers are effected through the efforts and initiative of the acquiring company. Secondly, the shareholders of all companies are affected by amalgamation, whereas in mergers the shareholders of the absorbed company only are affected.

Advantages and Disadvantages. Consolidation secures almost all the advantages of combination. Having a permanent and complete control over the enterprises, it makes for greater centralization of authority and more effective management of the business ; and it avoids the diversity of interests inherent in a partial consolidation like the holding company. It can dispense with the expenses required in maintaining different corporate structures that become necessary for a holding company. Because of its large size, it can borrow funds at low rates of interest and can offer the entire property of the company as security for a loan through mortgage which cannot be effected by a holding company. It eliminates the wasteful duplication of plants, and on the productive side, a thorough rearrangement and specialization of work can be carried out.

The formation of a consolidation involves the purchase of total assets of combining enterprises, and accordingly, it becomes very expensive. Once formed, it cannot withdraw its association from any fused units, even when they may appear unprofitable. The goodwill and reputation of absorbed units may be lost, and the shareholders of the absorbed companies are likely to have little voice in management of the consolidated company. Unlike a holding company, it cannot avoid business risks, and it becomes subject to the full blast of Government regulations and public censure.

Consolidation by Lease. In order to reduce the cost of consolidation, consolidations by lease are formed in the case of public utility companies and mining companies. It is not a suitable form of combination for manufacturing enterprises. In our country, for example, both the Tata Iron & Steel Co. Ltd., and the Indian Iron & Steel Co. Ltd. hold important mining leases for the supply of their requisite materials. This lease arrangement is advantageous to the lessor as well as to the lessee. Shareholders of the leased subsidiaries are assured of a fixed guaranteed income, since rentals are payable whether earned or not. The holding company, as a lessee, gains control over the property without incurring the huge cost of acquisition.

Consolidation and Cartel. These two important forms of combination can be distinguished in the following respects :

1. *Origin*—Germany is the home of the cartel whereas the United States is the classic land of giant consolidations. Moreover, the attitude of the German Government was favourable to the growth of cartels in the country. In contrast, the combination movement in the United States has developed against terrible opposition from the public and the Government.

2. *Organization*—Cartel is a loose type of organization based upon an agreement of the combining units. It involves horizontal integration of business enterprises formed at the time of depression particularly. On the other hand, consolidation is an organized combination formed under an incorporated association. The combining units in a consolidation are fused into one bigger unit in which the identities of competing enterprises are lost. Consolidation may be the result of vertical integration or horizontal integration ; and it can be established at any phase of trade cycle, whether boom or depression.

3. *Independent and separate existence*—Participating units of a cartel organization retain their separate existence and almost full independent control. They agree mutually to restrict their freedom of action in respect of one or two aspects of business operations for the common benefit. But in complete consolidation, dependent companies are totally eliminated from the scene. In cases of partial consolidations like the holding company and the trustee device, a much higher degree of control is exercised over the federating units as compared with cartels.

4. *Aims and objects*—Cartels aim at the elimination of competition from the organization so that they can maximize their profits by controlling prices through some restrictive methods. On the contrary, complete consolidations do not usually eliminate competition, and their primary object of expanding profit is realized through various operational economies, not through the enhancement of prices. Partial con-

solidations, however, occupy a halfway position between the two extreme cases.

5. *Efficiency and economy*—Cartels never attempt to improve the productive efficiency of the member units. They have no regard for the promotion of ultimate interests of their members ; instead, they take a shortsighted view of earning the highest possible profit within a short period. In contrast, consolidations are based upon a solid economic foundation, and they attempt at securing all the economies in production, management, marketing and finance. Cartels, at best, can secure some economies in marketing only.

6. *Extent of activities*—Cartels are very wide in their scope and they may include all the important units of a particular industry under their fold. Moreover, they may extend their activities beyond national boundaries so as to include some foreign competitors as members of the organization. On the other hand, consolidations rarely cover all the units of an industry within a country ; and they hesitate to extend their influence outside the country for various reasons.

7. *Stability and durability*—Because of the innate conflicts of interests, cartels are essentially unstable forms of combination. They are fair-weather organizations ; at the time of depression, they may work well ; but during the boom period they tend to be disrupted and dismantled. As opposed to this, consolidations are both stable and permanent forms of combination. Divergent interests of different concerns are submerged in one joint and common interest of a single enterprise.

8. *Social viewpoint*—The public hold an antagonistic attitude towards cartels which charge high prices and reduce the amount of goods or services available for sale. But there is much to support consolidations from the social point of view. No doubt any large combination gives rise to some evils, yet combination through outright consolidation is the least objectionable organization from the social side.

COMBINATION IN INDIAN INDUSTRIES

Combinations were virtually absent in business enterprises of our country before the grant of discriminating protection in the year 1921. The causes of this belated and slow growth of combinations can be traced in certain factors. Combination is the natural offshoot of an advanced industrial development which is wanting even today in our country. Industrial development, and along with it, the growth of combinations were retarded by the foreign Government which was motivated to promote the interests of British industries at the cost of our national industries in the pre-independence period. Too many small and scattered units have presented a formidable barrier to the formation of combina-

tions. The individualistic and sectarian outlook of our industrialists has aggravated the situation still further. Last but not the least, the prevalence of managing agency system arrested the growth of formal combinations because of its effecting widespread managerial and financial integrations.

However, the present position of combinations in industries of the nation may be studied under three aspects, *viz.*, industry-wise combinations, form-wise combinations and joint enterprises with foreign collaboration.

Industry-wise Combinations. *Jute*—The Indian Jute Mills Association (I.J.M.A.), formed in 1886, has successfully controlled the productive capacity of the industry to check uneconomic fall in prices, and it has set up an Institute of Jute Technology to promote research and technical developments in the jute industry. At present, it controls about 90% of the production, and it has steered the industry clear of its adversities on many occasions.

Cement—The Cement Marketing Company was set up in 1930 with the object of centralized marketing of cement. To make the combination more effective, 11 cement companies went into liquidation in 1936 for re-establishing themselves under a giant company by the name of "the Associated Cement Companies Ltd." or the A.C.C. The giant A.C.C. holds all the shares of the Cement Marketing Company. Sahu Jain and Dalmia groups of cement factories were left outside this combination, and consequently they offered tough competition to the A.C.C. Efforts were not spared to make a quick and satisfactory arrangement between the groups under which the market was divided to their mutual advantage. Some additional factories have been erected in the meantime by both the groups. About 70% of cement production is estimated to be under the control of this combination. To reduce the dominating influence of these groups in the private sector, the Cement Corporation of India has been recently established in the public sector for augmenting cement production in the country.

Sugar—The sugar industry fell in distress within a decade of its setting up on account of over-production, and the resultant fall in price. With the object of controlling prices by the quota system of production and centralized selling, the Cawnpore Sugar Syndicate came into existence in 1937. Roughly two-thirds of the sugar factories participated in this combination, and the remaining one-third factories which were widely dispersed throughout the country did not come under this organization. The Government forced this combination out of existence in the year 1950, because the syndicate assumed activities in restraint of trade and against public interest. But the Indian Sugar Mills Association is there to undertake precisely the same function which

was discharged by the defunct Sugar Syndicate. To reduce the importance of this combination, the Government is encouraging the expansion of the co-operative sector in sugar industry. There were 81 sugar co-operatives in 1969 representing about one-third of the total installed capacity.

Paper—In the paper industry, unification of several mills representing about 78 per cent of the installed capacity has been effected under the Indian Paper Mills Association. This association controls prices and allocates among the participating units the standing Government contracts which come to about one-fourth of total production of the industry. The size of paper plants is very small in India. Out of 57 paper mills operating at the end of 1966, only 10 had a production capacity exceeding 30,000 tonnes per annum. In the public sector, the Hindustan Paper Corporation is setting up units at Nagaland. Nowgong and Cachar for manufacturing paper and pulp. In addition to the existing newsprint mill at NEPA, another newsprint mill in the public sector is coming up in Kerala. The installed capacity of the industry is proposed to be raised from 9.2 lakh tonnes in 1972 to 1.1 million tonnes at the end of 1973-74.

Iron & steel—Barring the steel plants in the public sector, the entire productive capacity of the iron and steel industry in the private sector is under the control of two big firms, *viz.*, the Martin Burn & Co. Ltd., and the Tata Industries Ltd. The Steel Corporation of Bengal was formally consolidated by merger into the Indian Iron & Steel Co. Ltd., in 1953 under the directive of the Government. Because of steep fall in production and poor plant conditions, the Government took over the management of IISCO with effect from July 1972. For the steel plants in the public sector, the Steel Authority of India Limited (SAIL) has been organized as a holding company in January 1973.

Match—The Western India Match Company (WIMCO) controls more than two-thirds of India's match output. The WIMCO is controlled by the powerful Swedish trust, Ivar Kreuger, that has succeeded in setting up branches throughout the globe.

Form-wise Combinations. All combinations, irrespective of the forms, have been established in India by the mediate or immediate influence of the managing agency system. Consistent with the nature and requirements of different industries, managing agents took resort to various forms. Combinations in Indian industries may be grouped under the following forms :

Formal agreements—The pooling or cartel agreements are to be witnessed in several industries like jute, cement, sugar, paper making, petroleum refining as well as in shipping lines. (1) In the jute mill industry, the Indian Jute Mills Association has assumed the character

of an output pool by limiting the hours of working and sealing productive capacity ; sometimes it has acted as a selling syndicate for the centralized marketing of products manufactured by its member mills. (2) In cement industry, the Cement Marketing Company is a cartel organization of the selling syndicate type. The subsequent agreement between the A.C.C. and the Dalmias concluded in 1940 for the division of the market bears illustration of the market pool. (3) In the sugar industry, 92 sugar mills joined together to form the defunct Sugar Syndicate as a cartel organization for the centralized marketing of sugar and for controlling prices with quota system of production. (4) The Indian Paper Mills Association engages in price fixation and allocates Government contracts under pooling agreements made by the oldest three units of the paper mill industry. The mills that were established in subsequent years have come under the influence of this pooling arrangement in some form or another. (5) In petroleum refining industry, an absolute monopoly position was previously enjoyed by a handful of foreign concerns. Pooling agreements were concluded by the Burmah Shell with the Royal Dutch Shell, the British Burmah Petroleum Company and the Assam Oil Company for regulating prices of kerosene, gasolene and other by-products with a quota system of distribution. Although the Standard Vacuum (now ESSO) and the Caltex, being American companies, could not be a party to the pooling agreement, yet they supported this pooling agreement by their non-entry into any competition. The operations of IOC in the public sector has tilted the balance of control now in favour of the Government. (6) The agreement between the British Indian Steam Navigation Company and the Scindia Steam Navigation Company was an evidence of the traffic pool. The Indian Coastal Conference that was formed in 1951 had the object of controlling the coastal trade by Indian shipping companies.

Partial consolidations—Both holding companies and communities of interests were established by the well-known managing agency companies. There are four industries, *viz.*, jute, plantation, coal and cement, in which the existence of holding companies is to be witnessed. In the early fifties of the century, one-fourth capacity of the jute mill industry was controlled by two leading managing agents, six managing agents controlled 96 tea gardens ; four managing agents controlled 30 colliery companies ; and two managing agents controlled 20 cement companies.[2] Besides, there are evidences of holding companies in the concerns previously managed by managing agents in cotton, sugar and match industries.

As regards interlocking directorate, it was estimated in 1951 that nine leading families of India held 600 directorships, and 100 top-

[2] Mehta. M. M., *Structure of Indian Industries.*

ranking executives held 1,700 directorships in Indian industries. As to the form of managerial integration, 359 industrial concerns were controlled during 1954-55 by a group of 17 top managing agencies with as many as 10 to 40 companies to their individual credit. This control over 359 companies having a total paid-up capital of Rs. 114 crores was equivalent to controlling about one-fourth of the aggregate paid-up capital of all companies under the managing agency system and about one-eighth of the total paid-up capital of the corporate enterprises. In the sphere of financial integration, all leading managing agents had control over several banks and insurance companies. For example, the Tatas have established two investment trusts, *viz.*, the Investment Corporation of India Ltd., and the Investa Industrial Corporation Ltd. Moreover, they had controlling influence upon the Central Bank of India, the Bank of India, the Bank of Baroda, and the New India Assurance Company.

Complete consolidations—The British India Corporation started its career in 1920 by taking over six companies through amalgamation and absorbed in 1946 several other concerns under the control of Begg Sutherland & Co. The A. C. C. came into existence as a result of amalgamation in 1937. The amalgamation of three cotton mills led to the growth of Buckingham Carnatic Mills. Again, Jardine Skinner & Co. and George Henderson & Co., were amalgamated in 1946 to form Jardine Henderson Ltd. Likewise, Macneill & Co. and Barry & Co., were also amalgamated in 1949 to form Macneill & Barry Ltd. Both these groups have extensive interests in jute, tea and coal companies. Much earlier, Martin Burn Ltd., was formed through amalgamation of Martin & Co. and Burn & Co. Lever Brothers (India) Private Ltd., absorbed three companies of the Unilever group in 1956 and was reconstructed as Hindustan Lever Ltd. Recently, many mergers and amalgamations took place by the transference of managing agency rights from European businessmen to Indians.

Joint Enterprises. In recent years, the combination movement has entered a new phase with the formation of joint enterprises by Indian and foreign businessmen. Established enterprises of other countries have collaborated with the leading Indian business houses for the setting up of new business concerns in many fields of activities. In the automobile industry, the Hindustan Motors Ltd. was started as a result of Birla-Nuffield enterprise, the Ashok Motors Ltd. came into existence through the help of the Austin Motors, the Premier Automobile Works was established by Walchand Hirachand in collaboration with Chrysler Corporation, and the other two important concerns, *viz.*, the Standard Motor Products of India Ltd., and the Telco were set up in a similar way. In other industries, the National Rayon Corporation Ltd., the

Sirsilk Ltd., the Hindusthan Pilkington Glass Works Ltd., Sen-Raleigh & Co. Ltd., the Tribeni Tissues Ltd., and several other concerns in chemical and engineering fields bear testimony to these joint enterprises. An ever-increasing number of joint enterprises is taking place from the middle of 1958. As many as 3,193 collaboration agreements were approved by the Government in the period from 1957 to 1970.

Even these joint enterprises have been formed at the State level. The Central Government has invited the German, the Russian and the British steel interests for the setting up of the three different steel plants in India ; it has also sought help of a Swiss firm for establishing the Machine Tools Factory in the country. Different State Governments have entered into agreements with foreign concerns for manufacturing fertilizers, chemicals, tractors, etc. Moreover, the three well-known oil companies, the Standard Vacuum, the Burmah Shell and the Caltex were permitted by the Government to set up three Indian subsidiary companies.

These joint enterprises have been criticized on the ground that they would create new vested interests in the country and would hamper the economic progress of India. They have been referred to as "illegitimate marriages", between Indian and foreign big businesses. But in the context of absolute dearth of technical know-how and capital equipments in certain lines of business, some vital industries could not be set up in the country without the help of foreigners. However, all such schemes of joint participation are examined by the Government for safeguarding the ultimate interests of the country.

GOVERNMENT POLICY ON COMBINATIONS

No fixed policy has been crystallized into the form of a specific price of legislation on matters of combinations. And yet, the views of the Government on issues of combination can be ascertained from the provisions of a number of statutes. In some cases the Government intends to encourage the growth of combinations, while in others it aims at preventing the formation of such combines. Monopoly combines working to the detriment of public interest do not find favour with the Government. For the transformation of uneconomic sizes to economic ones, the Government took the initiative in 1952 for the merging of SCOB into IISCO, formed in 1968 the National Textile Corporation for assuming control over sick cotton mills and established in 1973 the Coal Mines Authority Ltd. for taking over management of all collieries. The dissolution of the Sugar Syndicate in 1950 provides the solitary instance where the Government was active in breaking a monopolistic concern.

With a view to checking the evils of monopolies, there exist the Tariff Act and the Essential Commodities Act for ensuring fair prices

to the consumers, the Industries (Dev. & Reg.) Act for curbing monopolistic trends, and the Companies Act for preventing multiple directorship and managerial integration. The financial integration is regulated not only by the provisions of the Companies Act, but by the measures of the Capital Issues Act and the Banking Companies Act as well. All attempts at controlling monopolies have culminated in the enforcement of the Monopolies and Restrictive Trade Practices Act, 1969.

Mahalanobis Committee. Despite the operation of so many countervailing measures against the growth of monopolies, the degree of industrial concentration is not negligible in the country. The data published in the Census of Manufactures in 1955 reveal that five per cent of the registered factories produced over 60 per cent of the total value of manufactured goods and four per cent of the factories contributed 61 per cent of the total employment. As a result, an insistent public demand was made in the Parliament in 1960 for undertaking a survey of holdings in the industrial field by various groups of industries and business houses. The Planning Commission appointed in October, 1960 an enquiry committee under the chairmanship of Dr. P. C. Mahalanobis for studying recent trends in the distribution of income and wealth, reviewing the changes in the levels of living in First and Second Plans and for ascertaining the extent of concentration of wealth and means of production. The Committee came out with the findings that in spite of planning for ten years there exists a considerable degree of inequality in the distribution of economic assets and the resultant concentration of economic power in the hands of a few persons. The Committee reported that concentration of control in the corporate sector was serious. Fifteen big banks, out of 363 Indian banks accumulated 78% of the total deposits in 1959. Twenty leading groups of business houses increased the share capital of their controlled companies from Rs. 238 crores in 1951 to Rs. 352 crores in 1958 mainly through the inter-company investment of funds. The Committee recommended for the collection of comprehensive and detailed information on varied aspects and ramifications of concentration by the appointment of a full-time agency.

Monopolies Enquiry Commission. Based on the recommendations of the Mahalanobis Committee, the Central Government appointed a five-member commission in April, 1964 under the chairmanship of Mr. K. C. Das Gupta to enquire into concentration of economic power in private hands and to report the matter to the Government by the end of October, 1965. The Monopolies Enquiry Commission was constituted with wide terms of reference for examining the nature and means of concentration of economic power in the corporate sector and financial insti-

tutions as well as for reviewing the problem of monopolistic and restrictive practices along with a suggestion for suitable legislative and other remedial measures.

In the report submitted in October 1965, the Monopolies Enquiry Commission analysed the causes and extent of concentration of economic powers. According to the findings of the Commission, the important causes of concentration include the opportunity for centralized control under the corporate forms of business, the managerial integration and inter-corporate investments through the managing agency system, the purchase of British business houses by Indian industrialists in the post-independence period, the faulty systems of industrial licensing, capital issues control, import regulation and exchange control introduced by the Government and the practices of banks and other financial institutions in giving wider assistance to big business houses. The Commission analysed the extent of concentration from two approaches, *viz.*, the product-wise concentration and the group-wise concentration. In the case of product-wise concentration, the Commission found that there was a high degree of concentration in 65 products out of 100 examined by it and that more than 75 per cent of the total production in each of the sixty-five products was controlled by three top producers. In the case of group-wise concentration referred to by the Commission as country-wise concentration, it was found that 75 big business groups were controlling 1,536 companies having total assets of Rs. 2,606 crores. The position of the first ten groups is indicated in the following table :

Rank	Name of Business Groups	Total number of Companies in Group	Total assets in crores of rupees
1.	Tata	53	417.7
2.	Birlas	151	292.7
3.	Martin Burn	21	149.6
4	Bangur	81	77.9
5.	A.C.C.	5	77.4
6.	Thapar	43	71.9
7.	Sahu Jain	26	67.7
8.	Bird Heilgers	64	60.1
9.	J. K. Singhania	46	59.2
10.	Soorajmul Nagarmull	76	57.4

The Commission concluded that the dangers from concentration of economic power pose a serious problem and are to be averted or minimised by legislative and other remedial measures. As regards legislative measures, the Commission recommended the creation of a permanent

body for exercising constant vigilance over monopolistic and restrictive practices. The permanent body would keep a watchful eye on all big houses and enterprises for checking the growth of further concentration and would take suitable action for eliminating the evils of monopolistic and restrictive practices. Other non-legislative measures recommended by the Commission include (*a*) stoppage of accepting election funds by political parties from business houses, (*b*) liberalisation in industrial licensing for small industries, (*c*) safeguarding of consumers' interest in granting import licences, and (*d*) countervailing actions by way of extension of public sector undertakings, promotion of small industries, formation of consumers' co-operatives, etc.

The Monopolies and Restrictive Trade Practices Act. Based on the recommendations of the Monopolies Enquiry Commission, the Monopolies and Restrictive Trade Practices Act was passed in December 1969. The main provisions of the Act relate to (1) regulation of expansion as well as of consolidation of undertakings having assets of Rs. 1 crore and more with other concerns and the appointment of directors thereof, (2) regulation of the starting of new undertakings on the part of existing concerns whose total assets exceed Rs. 20 crores, and (3) control or prohibition of such monopolistic and restrictive trade practices as are found to be prejudicial to public interest. The Act provides for the establishment of a permanent statutory commission under the name of the Monopolies and Restrictive Trade Practices Commission (MRTPC) for controlling such undesirable practices. In addition, there are provisions for the appointment of two officials, the Director of Investigation and the Registrar of Restrictive Trade Practices for assisting the Commission in its work. MRTPC has been set up in August 1970.

SELECT QUESTIONS

(More important questions are marked with asterisks)

CHAPTER 10 : BUSINESS EXPANSION & SIZE OF UNITS

*1. Analyse the motives for the formation of business combinations.

2. Explain the advantages and evils of large-scale operations (or combinations) in industries. Discuss the causes of combination.

*3. Briefly discuss the factors which determine the optimum size of a business unit.

*4. When does a business enterprise become too big? Discuss fully.

5. State the ways and means of measuring the size of industrial establishments.

6. Give a short estimate of the size of industrial units in India in the case of (*a*) cotton textile industry, (*b*) sugar industry, and (*c*) cement industry.

* 7. Should small industries grow as ancillaries to large industries? Give reasons for your answer.

CHAPTER 11 : CLASSIFICATION OF COMBINATIONS

* 8. State the nature, benefits and limitations of horizontal and vertical integrations.

* 9. What are chambers of commerce? What functions do they perform? Describe the services they render to the business community.

10. Define a pool. What are the different types of pools? State briefly the advantages of pooling agreements.

* 11. What are holding companies and what are their advantages? Mention the statutory provisions for regulating holding companies in India.

12. Explain the chief differences between the cartel and the consolidation.

13. Write notes on—(*a*) Circular Combination, (*b*) Vertical Combination, (*c*) Trade Associations, (*d*) Informal Agreements, (*e*) International Cartels, (*f*) Community of Interests, and (*g*) Consolidation by Lease.

14. Trace briefly the growth of combinations in Indian industries with special reference to the forms which are mostly used in different industries.

15. Account for the formation of joint enterprises by Indian businessmen with foreign collaboration. Do you support the growth of such enterprises?

16. Indicate the Government policy on combinations in India with special reference to the Monopolies and Restrictive Trade Practices Act of 1969.

* 17. What is the extent of concentration of economic power in Indian industries and what are the remedial measures taken by the Government?

PART FIVE—MANAGEMENT IN ACTION

CHAPTER 12

OPERATING ORGANIZATION AND STRUCTURAL FORMS

MEANS OF GROUPING ACTIVITIES—DEPARTMENTATION

In Chapter 2 of the book we have seen that organizing involves four basic steps, *viz.*, determining total activities, grouping of such activities, allocating duties to individuals, and delegating authority to different positions. Of these four steps, the grouping of activities and delegation of authority require further considerations. From the grouping of activities emerge the departments, sections or units of an organization structure. And the patterns of organization or the structural forms are determined by the nature and extent of delegation in any enterprise.

There are different methods for the grouping of activities in any enterprise. The following are the important methods of classifying activities in all business concerns.

1. *Business functions*—The business functions or activities of an industrial concern include manufacturing, marketing, financing, purchasing, accounting, engineering, personnel, and the like of them. Important business functions are usually made the basis of creating departments in any organization. In classifying activities, a distinction is to be drawn between major or basic functions of a business and other supporting or service functions of the business. For example, engineering and purchasing activities are related to manufacturing operations of an enterprise. Likewise, advertising activities are concerned with the marketing function of a business. Separate departments are no doubt to be created on the basis of major or basic functions of the business. But the question arises as to whether separate departments are to be established for other activities like purchasing, engineering, personnel, etc. The size of the business determines the volume of work which, in turn, creates the necessity of different departments. For a small business, the engineering or purchasing activities may be grouped into the manufacturing department, while such activities may be organized into separate departments on the part of a large-sized business. Similarly, the finance department may include accounting and office activities in one concern, while such activities may be organized into separate departments in other establishments.

2. *Products manufactured*—A number of related products are usually manufactured by many industrial enterprises. When such a situation exists, the departments may be created on the basis of one single product or a group of products of the same category. Self-sufficient units or departments (technically they are called divisions) are created on the basis of products so as to make such units like independent business enterprises. For their independent functioning through the sale and manufacture of products, necessary service functions are provided to such autonomous units. Several large-sized concerns like the Imperial Chemical, Hindustan Lever and others have organized their activities on the basis of products. In insurance companies, the activities are grouped on the basis of their services into separate departments for fire, marine, casualty, etc.

3. *Regional areas*—Self-contained departments or branches may also be created on the basis of geographical areas of the business. Like the products manufactured, the regional areas provide the basis of classifying activities into several departments. And for the independent functioning of such departments, necessary service activities are arranged for each of the departments separately. Besides this use of regional areas in major classification of business functions, the territory is often selected for subdividing the marketing department into sections or small units.

4. *Others*—Apart from these bases, the homogeneous groups of customers and productive processes are utilized in subdividing the activities of the marketing department and the manufacturing department respectively. Customers are classified in different ways like children, men and women, or industrial buyers and domestic buyers, or factory workers, office workers and others. Manufacturing department may be subdivided into lathe, drilling, grinding and milling sections or into moulding, welding, assembling and painting sections.

Considerations in Grouping Activities. Although correlated and similar activities are grouped into several departments, yet difficulty arises in connection with those activities which can be placed under two or more departments. Recruiting and training of personnel are necessary on the part of several departments like production, sales and office. Where a separate personnel department cannot be created because of smaller volume of work, the personnel activities are to be organized on a logical basis. In many cases, recruitment and training of sales staff and office staff can be combined under one department, while separate arrangement is to be made for the staff of the production department. Again, traffic activities for collecting raw materials and despatching finished goods can be split into two departments. Or, they may be organized under one department which utilizes comparatively greater

traffic services. If circumstances permit, traffic activities may also be organized into a separate department for rendering services to both the production and sales departments.

The similarity of functions alone cannot provide any guide to classifying activities. Different activities must be intimately connected or associated with one another for making the operation of business an effective and economical one and for securing the needed co-ordination between activities. With these ends in view, activities are analysed into greater details to examine their contributions towards effective functioning of the enterprise as a whole. Responsibilities arising from different activities are assessed and relationships between two units are taken into account before assigning any activities to a particular department. Briefly, *activities analysis, responsibilities analysis* and *relations analysis* are the three important means of classifying activities.

NATURE OF DELEGATION

Delegation of authority is an important step in organizing. The process of dividing up the work of a business among people creates a number of jobs for both managers and operators. Organization being a mechanism to provide for integrated and co-operative action, all managerial and operating jobs are to be tied together in a consistent manner. Delegation is the cement that holds the jobs or positions together.

Since one person constitutes only one manpower, the chief executive of a company cannot personally manage all the activities of an enterprise. Obviously, for the individual departments, there must be departmental managers and for the divided sections of a particular department, there should exist sectional managers. These departmental and sectional managers derive their authority from the chief executive. The chief executive delegates a part of his authority to different subordinates for enabling them to discharge the work responsibilities or duties in all areas of the business. In delegating authority, the chief executive retains some reserved authority for his own performance as well as the power of demanding accountability from the subordinates for ensuring satisfactory performances on their part. This accountability can never be delegated by a manager to his subordinates and it always travels upwards in an organization structure. Because of this power of accountability, the manager at the helm of the affairs can exercise an overall control over the entire activities of any enterprise. That is, delegation is the means by which a manager can share his duties with his immediate subordinates who in turn delegate to their subordinates, and the process is continued until managerial work reaches supervisors at the lowest level of management and operating work is assumed by rank and file workers.

Delegation is a three-tier concept in organizing and has three essential aspects—(*a*) assignment of tasks or duties, (*b*) grant of authority, power or right, and (*c*) the creation of accountability or obligation.

Assignment of duty—As one manager cannot perform all the tasks, he must allocate a part of his work to subordinates. The sharing of duties between a manager and his subordinates can only be done when the work is divided into parts. In delegating duties, the manager has to decide what part of the work he will keep for himself and what parts will be transferred to his subordinates.

Grant of authority—Authority has a precise meaning in management. Besides the power to command or to give orders, it also means the right or permission to act for the company, to use company's property or to do other like things. If the delegated duty is to be discharged by subordinates, they must be granted requisite authority for enabling them to perform such duties. The same rights and powers as would have been necessary on the part of a manager for his self-performance are to be conferred upon his subordinates. However, as the total duty of a manager can never be delegated, authority delegation need not be full in any situation. The manager must retain some reserved duty and authority for his own performance; otherwise he ceases to function as a manager.

Creation of accountability—With the allocation of powers and duties to subordinates, there must logically go the obligation on the part of subordinates to render an account of their performance to the manager who delegates duty and authority to them. As the manager himself remains ever accountable to his superior for the satisfactory performance of work, whether delegated or not, he has to exercise control over the performance of his subordinates. This control over subordinates' performance is exercised through demanding accountability from subordinates. Duty and authority can be delegated by a manager to his subordinates, but accountability flows from subordinates to the superior in an upward direction.

Benefits and Difficulties of Delegation. There are five important benefits of delegation. *First,* delegation acts as a vehicle for co-ordination. By establishing structural relationships throughout the organization, delegation results in securing co-ordination and company unity. *Secondly,* delegation reduces the executive burden by way of relieving the superior of minor duties and allowing him to concentrate on major duties. *Thirdly,* delegation facilitates the expansion of business through extending and multiplying the limited personal capacity of the superiors. *Fourthly,* delegation permits the subordinates to increase their executive capacity through assuming greater responsibilities for decision making.

Finally, delegation improves the morale of subordinates by way of raising their status and importance in the organization.

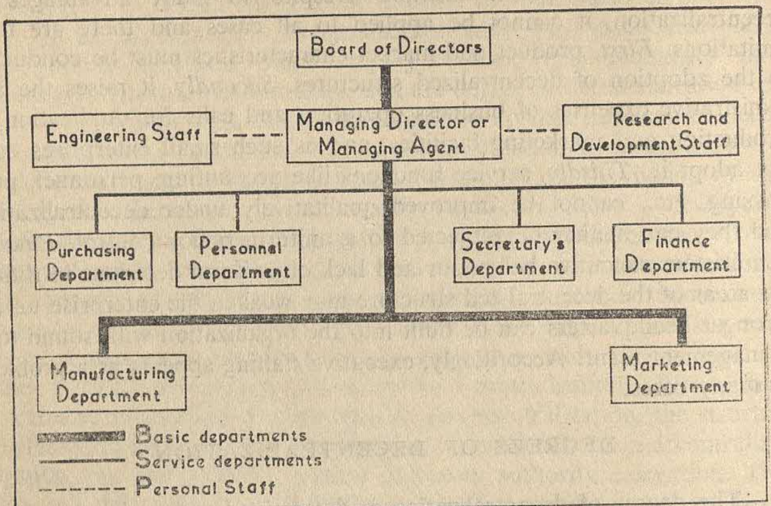
But effective delegation is confronted with three difficulties. *In the first place,* managers as human beings are subject to proneness of withholding authority on many excuses, and thereby authority is hoarded rather than delegated. *Secondly,* the practice in the art of delegation becomes perfect through experience over a long period and inexperienced managers cannot weave the different facets of delegation into a neat superior-subordinate relationship. *Finally,* incapacity of subordinates constitutes a real bar to delegation. Subordinates are to be trained, coached and developed properly for assuming responsibilities of delegated authority.

Principles and Practices of Delegation. For making delegation effective in character, there are four pertinent principles. *First,* the assignment of duties is to be made in terms of expected results so that it becomes clear to the subordinates what activities they must undertake and what results they must show. *Secondly,* the duties, powers and obligations of subordinates are to be correlated to one another in every act of delegation. *Thirdly,* the limits of authority are to be indicated in clear terms to all subordinates by formal and informal methods. The clearer the limits of authority, the more effective becomes the nature of delegation. *Finally,* unity of command is to be respected, and orders to a definite group of subordinates should always come from one delegating superior.

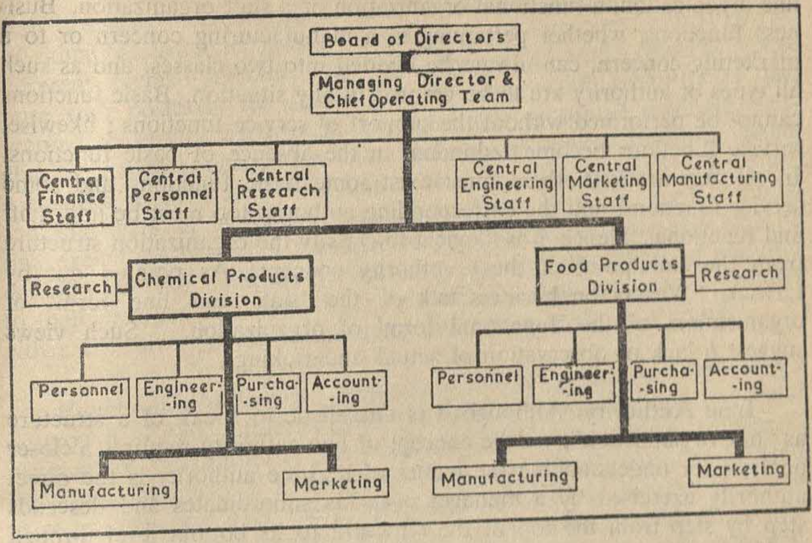
There are four recognized practices of effective delegation. *First,* specific delegation by way of delineating the exact nature of duty and authority is far better than general and vague delegation for making it effective. *Secondly,* the superior must adopt favourable attitude for establishing a close and cordial relationship with his subordinates. *Thirdly,* the superior should exercise control over the subordinates in such a way that their freedom is not curtailed seriously. The technique of control has been designed on a new basis. *Finally,* if the subordinates are not trained and developed, and they lack initiative and self-confidence, the degree of delegation shrinks in actual practice.

NATURE AND IMPORTANCE OF DECENTRALIZATION

Decentralization of Authority. Delegation of managerial work like planning, organizing, directing and controlling gives rise to the growth of decentralization in an organization. Delegation is a broader concept which includes operating work like production, sales, finance, etc., in addition to managerial work. Decentralization means the pushing down of authority and power of decision making to subordinate



Divisional Organization Structures. Self-sufficient divisions of the enterprise are created through the grouping of activities on the basis of products manufactured or regional areas of operation. To extend the limits of decentralization, almost all divisionalized companies have organized their divisional units on the *profit-centre basis*. The divisional managers are given ample authority for making independent decisions on problems arising in their own jurisdictions. Necessary service functions like accounting, personnel, engineering and purchasing are arranged for each of the divisions for making such units self-sufficient in character. As a result, co-ordination between business functions takes place at the divisional level. For controlling the activities of divisional managers, predetermined standards of performance are established and communicated by the top-management team. Greater decentralization does not mean weakening of the position of headquarters. On the contrary, decentralized organizations require a highly skilled and well-qualified central staff for establishing accurate standards, both operational and financial, of work performance on the part of each division. Furthermore, the central staff remains engaged in research, development and innovations work for the whole organization. Unless the headquarters can be built into a strong entity, decentralization may do more harm than good. The organizational arrangement of a divisional organization structure is illustrated in the following diagram.



TYPES OF AUTHORITY RELATIONSHIPS

Different managerial positions in an organization are tied together into a neat pattern of relationships through the delegation of authority. Authority relationship is the cohesive force that integrates the different parts of an enterprise into one complete whole. This authority relationship can be either line, staff or functional. Business functions are divided into two classes—basic and service—according to the nature of such activities. Basic business functions mean those functions which are necessary for the realization of end results or goals of the enterprise, and they include in most cases production and sales activities of the business. Some other business functions like personnel, purchasing, engineering, accounting, inspection, etc., are called service functions, because they render services or give help to the basic functions for their successful completion. Managers engaged in basic functions are usually entrusted with line authority, and managers engaged in service functions are given staff authority as well as functional authority by the chief executive of any concern. From the nature of these types of authority distribution, the position and interrelationship of different managers in any organization are determined.

Organization structures are often erroneously divided into line, functional, or line and staff. Because of the existence of line authority, functional authority or staff authority, a structure cannot be called a

line organization, a functional organization or a staff organization. Business functions, whether pertaining to a manufacturing concern or to a marketing concern, can always be divided into two classes, and as such all types of authority are to be granted in any situation. Basic functions cannot be performed without the support of service functions ; likewise, service functions become redundant in the absence of basic functions. In all organizations, there must exist some basic functions and some service functions, and the corresponding authority too must be line, staff and functional. Hence, it is illogical to classify the organization structure from the standpoint of these authority concepts. As pointed out by Urwick, "Writers on business talk of the 'staff and line form' of organization, of the 'functional form' of organization. Such views suggest a lack of observation of actual undertakings."[2]

Line Authority. Although it is unrealistic to speak of a structure as "line organization", yet the concept of line authority requires a closer analysis for understanding the nature of it. Line authority is the direct authority exercised by a manager over his subordinates and descends step by step from the top of the structure to its bottom level through a downward delegation of authority. The process of delegation thus sets up a chain of superior-subordinate relationships throughout the structure. The superior manager exercises a command authority over his subordinates. That is, he has the authority of giving orders and demanding accountability of their performances. The line authority acts not only as the avenue of command to the operating personnel, it also provides the channels of communication and co-ordination in the enterprise. Policies, orders or instructions, on the one hand, and the reports, suggestions or grievances, on the other, move up and down the structure through the medium of line authority. Line authority becomes the artery in the organization for conveying all messages to their desired places. It provides the basis of teamwok and encourages quick decision making and high work performance. Because of this line authority, a greater focusing of efforts can be done on the primary and basic functions of an undertaking.

Staff Authority. Staff authority is an advisory authority granted by a superior manager to some specialists in the organization for giving advice or making recommendations to him. The staff specialist has no direct connection with other managers of the organization or with the subordinates of the superior who confers authority upon the specialist. Thus the flow of staff authority is always upward and remains confined to giving advice or counsel to the superior manager. Illustrations of

2 Urwick, L., *The Elements of Administration*, p. 68.

staff positions include legal adviser, tax adviser, public relations officer or other "assistant to" posts. These staff positions are created in two different forms—*personal staff* and *specialized staff*. Besides these pure staff positions for advice purposes only, staff authority is also granted to service department managers like personnel manager, purchasing manager, accountant, etc. Service department managers being specialists in their own field can advise the chief executive or other top managers in an effective manner. Even in some special cases, line executives like sales manager or production manager may also be vested with staff authority for advising the chief executive in addition to their enlarged line authority. Accordingly, staff authority is granted either exclusively or in conjunction with other types of authority.

Functional Authority. Functional authority has appeared as an outgrowth of staff authority over the last few decades, and the usual recipient of this authority has been the service department managers. Functional authority is a strictly defined and limited authority granted to some managers over the personnel of other departments for giving "functional guidance" in respect of policies, procedures, methods or like phases of their work. Functional authority is thus an encroachment upon the wide and unlimited authority of departmental managers over their own people. But this encroachment has been found to be inevitable in the present-day complex business operations which are subject to Government regulations, trade union activities and other outside forces. These regulatory and restrictive measures require uniform policy control and procedural operations in all departments of the organization. For example, the personnel manager is granted functional authority over the personnel of other departments to see that labour laws are duly complied with or employee grievance procedures are uniformly gone through in all departments of the organization. Again, staff executives who are appointed for giving advice to the appointing superior only may also be authorized to make recommendation or give advice direct to the subordinates of the superior. For this direct dealing with subordinates, the staff executive is vested with requisite functional authority. Besides, there are special circumstances under which even a line executive may be granted functional authority.

Leaving aside special cases, it can be said that service department managers become the recipients of all the three types of authority. To illustrate, the personnel manager is granted line authority over the subordinates of his own department, staff authority for giving advice on personnel matters to the chief executive and other senior executives and functional authority over the personnel of other departments for giving functional guidance in respect of specified matters. But in giving functional guidance, the personnel manager cannot make the subordi-

nates of other departments accountable to him ; but such subordinates remain accountable to their respective controlling managers who exercise line authority over them.

Line and Staff System. Since functional authority is merely an outgrowth of staff authority for meeting special situations, and since functional authority is combined with staff authority in managerial positions of service departments, we can say that basically there are two types of authority—line and staff. From the overall organizational viewpoint, managers engaged in basic functions are granted line authority, and managers engaged in service functions are given staff authority for giving advice and service throughout the organization.

The difference between line authority and staff authority can be explained by discussing the operational practices of these two managerial positions. Generally speaking, the accountant or personnel manager has staff authority, while production manager or sales manager possesses line authority. In actual practice, however, both the accountant and personnel manager have not only command authority over the employees of their individual departments, but also they are supposed to give advice or service to the subordinate managers employed in the production department or in the sales department. On the other hand, production manager and sales manager exercise command authority over the field workers through the medium of several subordinate managers and they have no obligation of giving advice or service to other departments. *Secondly,* line managers (managers with line authority) assume direct responsibility for the realization of primary aims of the business. As business means production and sale of goods or services rather than account-keeping or recruiting and training personnel, line managers owe an accountability to the chief executive for the show of work performance. If production or sales volume falls, line managers have to explain the causes of poor business performance. Staff managers are never expected to account for any poor performance of the business, because they supply merely gadgets, techniques or facilities to line managers. *Thirdly,* the cost of the staff departments or positions is an "overhead burden" from the business point of view. The lower the burden of such expenses, the greater will be the profit or success of the enterprise. In contrast, the cost of line departments is a direct expenditure for the operation of the business and the scope for reducing costs is much limited in these spheres of work.

LINE AND STAFF ORGANIZATION

Any organization must be of the combined line and staff type, and it cannot be otherwise. Under this combined line and staff authority

relationship, two types of executives or managers are introduced in all organizations. Line managers assume the power of command and direction in the enterprise, while staff managers merely serve in an advisory capacity and have no directive or executive role to play in the organization. In order to relieve the burden of line executives and to secure the benefits of specialist services, the staff managers are introduced in the organization. Although line managers are required to consult the appropriate staff managers before taking any important decision, yet the line executives are free to act in their own way even against the advice of staff managers. This right of line managers to ignore staff advice is granted because of the requirement of their accountability to higher authorities ; in contrast, staff managers have no such accountability. However, this right to ignore the staff advice has acted as a bar to the development of a harmonious line-staff relationship in many organizations and has deprived them of the full benefits of staff service.

Merits and Demerits. The line and staff organization has the following merits :

1. It permits to secure the full benefits of specialization by requiring the line personnel to concentrate on basic activities of the business and by engaging the staff men to provide necessary advice and service.
2. The expert advice and specialist service of staff men enable the line personnel to improve their performance and productivity.
3. Accountability of performance being the exclusive concern of line managers, it helps in maintaining unity of command and unity of direction in the enterprise.
4. Line authority being the carrier of command, communication and co-ordination, it ties the different segments of the enterprise as an integrated whole.
5. It is designed to give greater emphasis on basic activities in preference to service activities.
6. It facilitates executive training and management development.

Demerits of the line and staff organization include the following :

1. Although line and staff arrangements are based on the assumptions that they should support each other, the establishment of a harmonious line-staff relationship is a baffling task.
2. The failure to utilize staff advice on the part of line managers makes the staff men redundant in many cases.
3. Staff men have the innate tendency towards empire-building and they dominate over the lower-level line managers rather than serving them.
4. Because of their professional bias and unfamiliarity with the operational aspects of work, staff men give in many cases such impractical advice as cannot be worked upon.

5. It results in increasing the overhead cost of running the business unless the staff men can be given sufficient volume of work in any enterprise.

COMMITTEES IN ORGANIZATION

Committees mean a body of persons entrusted with discharging some assigned functions as a group and in a corporate capacity. Group discussions and group decisions are the identifying marks of the committee form. Committees may be permanent or temporary in life and may have staff or line authority in capacity. Permanent committees are referred to as standing committees, while temporary committees go by the name of *ad hoc* or special committees. Whenever committees are vested with a staff authority, they are known as advisory committees. Many advisory committees are found to operate in business enterprises. Some of the usual advisory committees in business include finance committees, works committees, sales committees, and the like of them. Wherever committees are vested with a line authority, they are called executive committees. Executive committees are required to take decisions as well as to enforce decisions, while advisory committees confine their activities to giving advice or making recommendations. The board of directors is an executive committee and becomes what is known as "plural executive".

Committees are created for different purposes like pooling of knowledge and experience on the part of several managers, providing participation to employees in decision making for enlisting their co-operation, securing the facility of co-ordination and communication, and giving representations to various points of view on those matters which affect several parties. Committees are also created for maintaining the balance of power in the organization as well as for evading executive responsibilities in regard to unhappy situations. The defects of committees are manifested in their lack of initiative, indecisive action, irresponsible character, compromising attitude, and wastes of time and money.

CHAPTER 13

THE PROCESS OF PLANNING AND CONTROL

NATURE OF PLANNING

Planning is one of the fundamental functions of management. Planning is the conscious determination of ways and means of a future course of action. There are several ways in which a specific work can be done; planning involves the choosing of one best course of action from several alternatives for accomplishing the task with a greater certainty and a considerable economy. Absence of planning before doing any work amounts to rashness or short-sightedness in the performance of that work. All questions like what the magnitude of work is, and when, where, how or by whom the work is to be done, are required to be settled in planning. With these ends in view, planning maps out a programme indicating the future course of action to be followed in any enterprise. The programme is laid out on the foundations of individual plans like policies and procedures focused on objectives of the enterprise.

Planning leads to faster and more effective achievements in any organization. As planning foresees the future and makes provision for it, it is instrumental for continuous growth and steady success of an enterprise. Planning supplies the milestones and provides the guideposts in the journey of business towards the unknown future. Furthermore, planning sets up standards of work performance by determining the amounts of time, money and energy required for the performance of any work. No effective control can be exercised without the help of standards. Accordingly, the controlling function of management is dependent and based upon the planning work. To be sure, control means that subsequent events or performances conform to the planned course of action.

Components of Planning. As planning results in chalking out a future course of action, the programme of work gives a tangible shape to such rational thinking about ways and means. The programme welds together in a co-ordinated fashion all answers to queries that may arise in the operation of business. In business planning, the programme is mapped out very often by the preparation of several budgets. Budgets are prepared for all areas of the business like production, sales, finance, etc., and they are integrated afterwards into a master budget for the whole enterprise. Budget making or budgeting is to be taken as planning, because it indicates the future course of action. Budgeting is not under-

taken in all enterprises ; but absence of budgeting does not imply that no planning is made in these enterprises. A programme for future activities serves the same purpose as budgeting does in some enterprises. The results of planning may thus be expressed by way of programming or budgeting.

Objectives—Whatever might be the expression of planning, no thorough planning is possible without the formulation of objectives, policies and procedures. Objectives are basic plans which fix the ultimate goals or end results to be realized from any work. Objectives are determined not only for the business as a whole, but also for the individual segment or area of the business. Objectives become guideposts in business. As work without guidance may lead to random activities, objectives are vital for the successful working of an enterprise.

Policies—Policies translate the objectives into realistic terms by the provision of work facilities and the regulation of human efforts in the enterprise. Objectives are concerned with the question of "what to do" in the enterprise, while policies deal with the aspect of "how to do" the work. For the general direction or guidance of activities, policies provide some standing answers. Within the boundary fixed by the policies, activities are to be carried on towards the fulfilment of goals or objectives of the business. Policies are developed in relation to each of the important activities of a business. Because of the importance of these policies, they have been discussed separately in the following pages of this Chapter.

Procedures—Procedures involve further breakdown of the objectives for the purpose of directing the activities towards the realization of objectives. Procedures provide a definite guide to any specific work of the enterprise. All the different steps involved in any particular work are determined and sequenced properly for their successful completion through the establishment of procedures. For example, purchasing of materials involves a series of tasks starting from their ordering to keeping them in store. These tasks which are required for the activity of purchasing are not done by one person ; a number of persons are engaged in different tasks involved. Procedures determine the number of tasks, the order of tasks as well as the persons by whom they are to be done. For smooth and co-ordinated functioning of the business, innumerable procedures are laid down relating to all facets of work in different areas of the enterprise. But procedures must not be confused with policies. Policies provide broad guides to thinking and action, while procedures supply definite guides within the area fixed by the policy. Policies can be interpreted to apply them in a number of related situations, but procedures do not allow any scope for interpretation.

POLICIES FOR THE BUSINESS

Policies provide the foundation upon which management activities

take place in organization. They are the means of securing co-ordination of efforts and activities in the enterprise and of supplying steadiness to an adopted course of action. Leaving aside other types of policies, we may confine our discussion here to policies relating to business functions like production, sales, finance, etc. Usually, a bundle of policies is developed in regard to each of the business functions. The common policy questions that arise in different areas of the business are listed as follows :

Sales Policies—(1) determination of markets as to number, type and location of customers ; (2) number, variety, type or quality of products to be offered in the market ; (3) pricing of products along with resale price maintenance, extent of trade discounts and market strategy to meet competition ; (4) marketing methods about distribution channels, packaging of products and use of brand name ; and (5) sales promotion covering types and media of advertising, personal salesmanship, market research and product innovations.

Production Policies—(1) manufacturing processes to be used and the extent of mechanization ; (2) the volume of output ; (3) materials procurement with quantities and modes of purchasing, and the selection of vendors ; (4) technical research and product design ; and (5) inspection practices.

Financing Policies—(1) size and source of block capital ; (2) amount and source of working capital ; (3) self-financing and dividend distribution ; (4) depreciation of fixed asserts ; (5) owning or leasing fixed assets ; and (6) trade credit terms.

Personnel Policies—(1) sources and methods of selection ; (2) extent and manner of training ; (3) compensation as to basic wage, bonus and other money benefits ; (4) working conditions along with hours of work, vacations, safety, hygiene ; (5) employee welfare through social and recreational facilities, housing, canteens, etc., and (6) industrial relations covering collective bargaining, union relations, code of discipline, and means of settling grievances and disputes.

ESSENTIAL STEPS IN CONTROL

Control ensures qualitative and quantitative performance of work in the organization. For the successful execution of plans, control brings to light all bottlenecks to work performance. It permits the management team to take corrective actions, to provide requisite facilities and timely assistance, to get the work completed in time, and to secure adequate performance in the business. The following are the sequential steps involved in control.

1. **Establishment of Standards**. Standards are the established criteria for measuring and evaluating individual and organizational per-

formance in any enterprise. Performance, whether high, low or normal, cannot be ascertained without the help of standards. The term "high performance" does not convey any sense unless the standard of normal performance is available. It is only when the concept of standard performance is established, the actual work can be judged or measured to see whether it is up to the mark or below the expected level. These standards are made available through the planning function of management. The goals, targets, costs or time schedules which are incorporated in the planning programme or in budgeting serve as standards of subsequent performance. As control implies the task of conforming events to expected results incorporated in plans, the first step in control involves a familiarity with such expected results which act as a beacon light for guiding control efforts.

Consistent with the nature of activities, different standards of performance are used in the business. Some of the common standards are physical or quantity standards, quality standards, cost standards, revenue standards or capital standards. In physical or quantity standards, the volume or quantity of work to be done by employees is laid down, while in quality standards the quality of work is stressed. In cost standards, the estimated cost of work in different areas of the business is determined through planning; through the use of revenue and capital standards, the amount of income or the amount of capital investments becomes a guide to action. For the evaluation of a particular work, two or more standards are very often used jointly. For example, the evaluation of actual production in the manufacturing department is effected by quantity standards, quality standards, cost standards as well as time standards. The staff activities of advisory and service nature cannot be measured and evaluated by quantity standards. For example, the performance of employees in the accounting, research, engineering and personnel units is not measurable by quantity standards. Usually, cost standards are applied through the preparation of expense budgets in those areas for evaluating performance.

For control purposes, the standards vary between two levels of an organization. Top management being concerned with organizational performance employs a group of standards that is different from the standards used for evaluating individual performance at the operating level. Generally speaking, top management personnel are more concerned with cost standards, revenue standards and capital standards. Again, standards may vary between departmental managers and sectional managers. Sectional managers and supervisors who are close to the work situation generally use time standards and quantity standards, but the departmental managers use cost and quality standards in addition to time and quantity standards. Thus, different standards are employed in

different areas and for different activities of the business for controlling work performance.

2. **Evaluation of Performance.** The second step in control is to compare the actual performances with their planned and predetermined standards. Whether work performances reach the standard or exceed the standard can be evaluated through measuring performance. Evaluation is not only concerned with finding out the extent of variations between planned and actual performances, but it is also concerned with ascertaining the reasons for the variation in performance. The reasons for variations are to be diagnosed and remedial prescriptions are to be suggested.

It is rather rare that actual performances would tally with planned performances in all respects. The quantity of performance may be lower or higher than the standard. No difficulty arises in the case of higher performances, since such efforts are always coveted by the management personnel. But in the case of lower performances, the margin of tolerance is to be settled for the approval or disapproval of such work. However, no fixed limit of variations or tolerances is prescribed beforehand, and each case is judged on its own merits and in accordance with the surrounding circumstances. There are activities in which a slight variation may be regarded as more serious than a wider variation in many other activities. Consequently, according to the nature of activities and facts of the situation, managerial acceptance of work performance is given differently.

There are innumerable activities in a business enterprise. No doubt all such activities can be placed under one form of control or another. But to control all activities of an organization, the cost of controlling would perhaps be greater than the cost of work itself. For avoiding such imbalances in costs of controlling, control efforts are concentrated on certain key or strategic points. Through the exercise of control over these key points, all activities can be placed under a broad measure of control, and the cost of controlling is kept to a minimum. Sales, production and cost are the three important areas which permeate or penetrate through all activities of an industrial enterprise. So the key points of control are selected with reference to these areas of operation. *Output, expenses and investment* provide the three important aspects of performance which are put under managerial control.

3. **Correction of Deviations.** The control process is extended to this step in those cases where the performance proves to be unsatisfactory. All deviations must be corrected before the completion of work. After the completion of work, there is nothing left to be corrected; wastes of time, money and efforts that are involved in faulty perform-

ance lie beyond the scope for corrections. Managers have to become helpless observers of such faulty or unsatisfactory performance; and no chastisement or rebuke to the employees can compensate the loss that is already incurred. It is clear, therefore, that corrective actions are to be taken during the continuance of work so that the end performance comes up to the level of expected results. For taking these corrective actions in time, control must be continuous in operation, and the work must be pursued by the managers step by step till its successful completion. Besides, the managers exercising control must be given ample authority for taking such corrective actions as may be found consistent with the nature of activities. If corrective actions are prescribed from the top of the organization, as it is done in the case of a centralized structure, the delay involved in ordering for the corrective action may take the performance beyond the pale of control. Enlightened management implies management by objectives and self-control. To make this self-control effective, requisite authority must be delegated to the managers who control activities of employees close to the work situation.

In the taking of this corrective action, financial accounting is of no avail. Control, to be effective, must be forward looking, not backward looking in character. Financial accounting deals with performances of the past and records the effect of such activities in financial terms. For taxation, dividend distribution and other like matters, financial accounting may be helpful. But as a guide to managerial action in the sphere of control, it has little value. Items of losses or extra expenditures incurred six months back may be indicated by financial accounting and the specific reasons for such losses may also be uncovered; but information provided cannot help the manager to avoid the past losses.

MEANS OF MEASURING PERFORMANCE

There are several means available for measuring actual performances in the light of standards established. The number of units produced, the quantity rejected, and the man-hours devoted are measured or counted on the part of each employee of the production department. Likewise, the number of calls attended, the units sold and the interviews granted by the employees of the sales department are measured individually. Sales and production being basic activities, individual performances can be measured physically through the use of quantity produced or handled by the employees. But performances of employees engaged in staff activities (service and advisory functions) cannot be measured physically in many cases. Usually, such activities are measured in terms of total performances through the use of managerial judgment, knowledge and experience. That is to say, tangible performances are

measured accurately, and intangible performances in the realm of thinking or mental efforts are assessed roughly by judging their contributions towards the realization of end results of the business.

Corresponding with the standards of performance, different tools of control are used for measuring performance. Tools provide the means of measuring performance and they vary with different levels of management. At the lowest level of management, performances are measured by personal observation and overseeing. At the departmental level, interviews coupled with occasional personal observation and written reports become the means of measuring performances. At the top level of management, written reports and returns provide the basis for control. Numerous reports relating to budget summaries, financial statement analysis, cost control data, return on investment, break-even chart, etc., keep the top-management team informed of actual performances in the organization.

CHAPTER 14

TOOLS OF FINANCIAL AND OPERATIONAL CONTROL

ACCOUNTING RECORDS AND CONTROL

The success or failure of any business enterprise is measured by the amount of profit or loss made and the financial position exhibited by it from time to time. The successful working of a business concern requires that adequate and reliable records are maintained to compile these two statements from its various activities. There is a statutory obligation on the part of all companies to render this information to their shareholders after getting it duly authenticated by the company auditors. Although other forms of business enterprises are not compulsorily required to maintain these records, still they cannot carry on their activities without getting this vital information. Such information is essential for sound operation and control of the business as well as for future guidance in matters of finance.

Profit is the cumulative result of all activities in a business. Consequently, an analysis of the profit involves an exercise of overall control of the enterprise. It is a matter of common knowledge that excess of income over expenditure iepresents the amount of gain or profit. The income of a business mostly comes from the sale of goods or services. Accordingly, to ascertain profit, the cost of the goods sold must be obtained, whether the goods are produced by the business or purchased from the market. The excess of selling price over this cost of goods sold is usually known as trading profit or gross profit. When all the operating and financial expenses are charged against gross profit, the business enterprise can determine its net gain or net profit. The operating expenses represent the cost of doing business, and financial expenses are mostly incurred in connection with borrowed funds employed in the enterprise. All these different groups of expenses contain a lot of information regarding the progress of the enterprise, and necessary probes into the items provide the management team with an opportunity to take remedial measures, if necessary.

The balance sheet exhibits the financial position of a concern by the inclusion of assets, liabilities and net worth of the business in a summary form. It is presented in an orderly and classified way to set forth the financial condition of the business on a given date ; but it does not incorporate the changes made in the assets and liabilities between two balance-sheet dates. It is simply a proprietorship equation showing the assets, on the one hand, and the liabilities and net

worth, on the other. The traditional form of it is a two-sided statement, the right side containing the assets and left side the liabilities together with proprietorship contributions.

To make the readers familiar with the items of a balance sheet, a condensed and simplified balance sheet is given as follows :

BALANCE SHEET OF A CONCERN

AS ON 31ST DECEMBER, 19 .

(Capital & Liabilities)	(Assets)
	Current Assets :
1. Accounts Payable	1. Cash in hand and at bank
2. Notes or Bills Payable	2. Accounts Receivable
3. Outstanding liabilities for expenses	3. Notes or Bills Receivable
	4. Inventories (Stock)
	5. Securities (Investments)
Fixed Liabilities : (Funded debt)	
1. Mortgaged loans	
2. Debentures	*Fixed Assets* :
Capital : (Net Worth)	1. Furniture and Fixture
1. Ownership Capital	2. Plant and Machinery
2. Capital surplus	3. Real estates
3. Earned surplus	4. Intangible assets— Goodwill, Patents etc.

Financial Statement Analysis. The two basic financial statements are the profit and loss account and the balance sheet. These financial statements in themselves do not indicate the progress made by the concern over past years or over other concerns. They alone cannot explain whether the condition of the business is more favourable or less favourable as compared with the preceding year. The comparative position of an enterprise can of course be obtained by drawing the financial statement in columnar form, under which amounts for past years are also noted against each item of profit & loss account and balance sheet. But this supply of total amounts for two or more years is not very helpful for comparative purposes. A more effective method of analysing the statement lies in the use of comparative ratios or percentages in respect of each item of the statements. There are

several ratios that can be obtained from the figures of the balance sheet, of the profit and loss account, or of the two combined. However, we may discuss here certain key ratios that are vital for the measurement of progress and solvency of any concern.

1. *Ratio of current assets to current liabilities* (working capital ratios)—As the difference between current assets and current liabilities represents working capital, this ratio is known as the working capital ratio. It is of primary importance in determining the current financial position of a concern. As current liabilities are usually paid from the funds arising out of current assets, the interrelations of these two groups of items are of wide significance. The higher the ratio, the better will be the solvency of the concern. It is estimated that the normal relationship between the two should be of the order of 2 to 1. About the current assets, it should be remembered that accounts receivable (book debts) may not be realized in time or in full and the inventory may go down in price. On the other hand, the accounts payable, particularly outstanding liabilities for expenses and bills payable, brook no delay. These items constitute definite commitments to pay that sum of money on a particular date, whether book debts and other items are liquidated in cash or not. Hence, there must be a sufficient margin to cover up possible contingencies.

2. *Ratio of cash plus receivables to current liabilities* (Acid test ratio)—Out of current assets, the liquidity of inventories is entirely dependent upon sales which may be regarded as an uncertain matter. Leaving aside inventories from current assets, this ratio is computed to find out the solvency of the business concern. Of the three remaining items of current assets, cash and bills receivable are completely reliable, and account receivables are dependent upon their average collection period. If the average collection period is normal, this ratio of assets to liabilities may be established at 3 to 2. Where book debts can be collected quickly, a lower ratio should be considered safe and satisfactory.

3. *Ratio of fixed assets to tangible net worth*—To get the tangible net worth of the business, the net worth or proprietorship section should be reduced by the amount of intangible assets shown in the balance sheet. In other words, it is the excess of capital and reserves over intangible assets like goodwill, patents, preliminary expenses, commission, etc. Any rise in this ratio indicates the necessity of heavy borrowings and reduction in the amount of current assets on the part of the business concern. This ratio is compared to that of past years, or that of other enterprises in the same line for the purpose of finding out any deviation from the normal. It is true that a business enterprise may work successfully for the time being in spite of an unusual borrowing, yet this is a danger signal which cannot be

overlooked by an alert management team. When the burden of fixed interest charges begins to exert pressure, the profitable position of the business may be reduced to a losing one.

4. *Ratio of current liabilities to tangible net worth*—We have already seen that if fixed assets are out of line with tangible net worth, the enterprise will be forced to increase its liabilities, whether current or fixed. Moreover, current assets will be reduced to prevent the possibility of borrowing heavy amounts. Through the process of increasing current liabilities, on the one hand, and of decreasing current assets, on the other, the working capital ratio may go out of gear. With the object of checking this unhappy consequence, this ratio of current liabilities to tangible net worth is computed by careful management of any business concern. This ratio furnishes an opportunity for taking remedial action before the head-long crash of the business enterprise.

5. *Ratios of total liabilities to tangible net worth*—This ratio explains the comparative contributions of ownership funds and borrowed funds in the working of the enterprise. The greater the proportion of borrowed funds to ownership funds, the higher will be the speculative character of the business enterprise. By taking speculative chances and undue risks, the owners may gain everything and the lenders lose everything. Greater risk in business implies either larger profits or the liquidation of the enterprise. In both the cases, the owners gain at the cost of others. In the case of larger profits, the lenders will get the same fixed interest earnings, and the entire balance of this larger profit will be taken by the owners. In the reverse situation of business failure, it is the lenders who will have to bear the burden of business failure because of their greater contribution of funds.

6. *Ratio of fixed liabilities to working capital*—If the amount of fixed liabilities is too large in comparison with working capital, the enterprise is likely to develop symptoms of hysteric fits. In an attempt to repay a part of the fixed liability working capital may be reduced through the depletion of current assets. Moreover, in order to meet fixed and heavy interest charges in lean years, working capital may be required to be reduced further. Once the enterprise impairs its working capital, management finds no other alternative but to make several window-dressing and face-saving arrangements during the continuance of working capital shortage.

7. *Operating ratios*—The working or operation of the enterprise can be explained by the establishment of several significant ratios between different items in the profit and loss account. The computation of these operating ratios helps management to direct its attention towards those specific activities which require improvement. Because all the activities of a business are controlled by the sales figure, all

operating relationships are established by expressing them as a certain percentage of net sales. The more important operating ratios that are used by businessmen include the cost of sales to net sales, the gross profit to net sales, the cost of running the business to net sales, and the ratio of net profit to net sales.

8. *Turnover ratio*—As the name implies, this ratio is concerned with finding out the transaction time or the rate at which different assets of the business are turned out. The profit of a business is mainly related to the frequency with which the assets are utilized. The turnover to total capital investments in any business can be obtained by dividing the total sales by total assets. Similarly, inventory turnover of a business represents so many times as the stock-in-trade is turned out in the business during a particular year. Inventories consist of raw materials, partly finished goods and finished goods. The average inventory for the year may be found out by dividing the opening and closing stock by two. With the help of this average inventory, the transaction time and the turnover rates for each item of the inventories can be calculated. For example, raw materials consumed in production are estimated at Rs. 10,000 and the average material inventory is found to be Rs. 1,000. If materials are divided by inventory (10,000÷1,000), we can easily get the inventory turnover as 10. That is, materials have turned out into finished goods ten times during the year, and at an interval of 36.5 days (365÷10), materials have been further utilized. Likewise, turnover rates of partly finished goods and finished goods are obtainable.

9. *Ratio of net profit to total assets*—This ratio shows the return on investments of a business enterprise. The efficiency of the enterprise can be ascertained by comparing this ratio with that of other business establishments.

10. *Ratio of net profit to net worth*—The progress of the business is largely measured by this ratio alone. Since the investments are made by the owners with the object of earning profits, this ratio is computed by all business houses, small or large.

BUDGETING AND BUDGETARY CONTROL

An analysis of financial statements may be of considerable importance in judging the past operations and the present financial position of a business. But for the future progress of the business, something else must be done by management. That is what is done through budgets. Budgets provide predetermined standards of performance for regulating efforts and activities in the enterprise. Budgets contain a planned forecast of future performance for a definite period of time. The planning function of management is usually exercised

through the setting up of budgets, since they provide goals of the business as well as guides to operations.

The framing of budgets is only one part of the job; budgets in themselves do not ensure that budgeted targets and operations would be accomplished. Positive efforts must be made and directions given by management for the execution of budgets. The control that is exercised for the execution of budgets is known as budgetary control. To get through the budget, a systematic checking of the budgeted activities must be adopted by management. The actual performance is measured in terms of budget expectancy, remedial action being taken to eliminate departures from the budget data, and necessary assistance being given for the realization of budget objectives. Budgetary control involves an overall regulation of the activities. Budgeting and budgetary control have thus different meanings. Budgets furnish the planned objectives and aims of the business; budgetary control directs the way for securing desired ends.

Sound budgetary programme should be based on a realistic appraisal of present situations and future uncertainties. Existing financial statements are utilized by management in making plans for the future. But future events cannot be predicted with pin-point accuracy. Accordingly, the rigid adherence to an ambitious budget may defeat its own purpose. Budgetary control must provide a means of reasonable adjustments in the programme so that it can meet unexpected circumstances.

Length of budget period—The budget period coincides with the usual accounting year in most of the enterprises. But where the production process extends over a longer period, and when long-range research or expansion plan covers several years, the budget period may be suitably adjusted to fit in with the requirements of the particular case. Further, industries having seasonal character of production should have a budget for each of the busy seasons. Budget is based on the production schedule in the case of those industries which work out job orders only in an intermittent and irregular fashion.

Types of Budget. Within the comprehensive master budget for the undertaking as a whole, there are several individual budgets guiding the activities of different departments of the business. Budgets can be compiled in financial terms of rupees, in production terms of units, or in some other terms. Again, a budget may be either a constant or a variable one. In the case of a constant budget, budget figures remain fixed and uniform for several years; variable budget uses varying figures for different periods. However, we may discuss here some important types of budgets.

Sales budget—A sales budget containing the sales forecast is the

starting point of a budgetary programme, since sales become the dominating activity in the business and the purchase estimate or the production estimate in a business cannot be made without having an idea of the sales. On the basis of past experience and of available current information relating to the state of demand, competition and new developments, the sales estimates are determined. A thorough sales budget usually expresses the sales of each product in terms of value as well as in quantity.

Production budget—A production budget must closely follow the sales budget so as to ensure a steady flow of goods available for sale. Adequate arrangements are to be made in advance for the supply of raw materials, labour and other stores that may be required in the production process. Larger concerns usually make a separate budget relating to the cost of production. Production budgets should indicate not only the quantity of production, but they must also show the time by which products are to be completed to meet the sales targets. A trading concern, instead of having a production budget, prepares a purchasing budget for the timely acquisition of merchandise scheduled to be sold. However, the minimum and the maximum quantity of each item to be held in reserve is to be determined on several considerations by all concerns.

Revenue and expense budget—This budget is prepared for the use of top management to ascertain the profitability of a budgetary programme. The budget is expressed in financial terms and is in the nature of a pro forma income statement for the future. The figures of sales budget and production budget are incorporated in the master budget which, in turn, is utilized for developing the revenue and expense budget.

Capital expenditure budget—Capital expenditures for the acquisition of fixed assets in the years ahead are planned and provided for through the preparation of this budget. To ensure the availability of capital at the right time and to prevent disruption in the normal working of an enterprise, this budget maps out the future capital expenditures over a long-run period.

Cash budget—A cash or financial budget involves estimates of all possible cash receipts and payments during the budget period. A detailed cash budget serves many important purposes. It ensures a steady supply of required working capital and provides for funds to meet current obligations of the business. Some unusual heavy payments like the purchase of fixed assets, the disbursement of interest and dividends and the redemption of debentures can be managed smoothly without causing any disturbance to the normal working of an enterprise. Because of its splitting up month by month, a cash budget provides information as to the amount required to be borrowed

and the length of time for which it is needed. This advance knowledge is conducive to the raising of funds on advantageous terms. Moreover, surplus funds in other phases of the budget period may be utilized in making investments, and thereby earning some income. Purchase of materials or goods is also facilitated by this budgeting.

Advantages of Budgetary Control. The following are some of the advantages of a budgetary programme :

1. Since budgets are all-inclusive plans in business, budgetary control integrates and ties together various activities. As a result, co-ordination is fostered by budgetary control. It provides the management personnel with an overall viewpoint for grasping and supervising all activities of a business concern.
2. Budgetary control secures the most effective functioning of the enterprise. Activities are measured by the previously set-up standards and any deviation calls for explanations and remedial actions. Weaknesses of the enterprise are revealed and eliminated.
3. Budgets are mapped out after intensive study and careful consideration. Objectives are established and made known to all members of the enterprise. Vigorous steps are taken to reach the scheduled targets. Consequently, the process of budgetary control develops a sense of responsibility, proportion and alertness on the part of the executives.
4. Financial planning becomes an integral part of the budgetary programme. All the financial aspects of the business are thoroughly examined and scrutinised by this process. All wastes of resources, human and material, are removed. Hasty and haphazard decisions are avoided that may result in useless spending.

COST ACCOUNTING AND COST CONTROL

In contrast to financial accounting which records the financial implications of past activities for owners' information and tax assessment purpose, cost accounting is designed to provide managers with information required for determining the cost of products and for exercising control in the organization. The cost accounting system is the recent outgrowth of traditional financial accounting. With a view to improving managerial control over business operations, the cost accounting system supplies information to managers and assists them in a number of ways. The cost accounting system has now become a major element in the controlling function of management. In the past, the system was concerned with analysing factory cost, determining

product pricing and ascertaining profit. Although these functions are still important, the scope of the system has been enlarged by the inclusion of many operational aspects of control in recent years.

Cost accounting is mainly concerned with cost finding and indicates what is the approximate cost of a process or a product under existing conditions. Cost control goes beyond the scope of cost finding and attempts at reducing costs by informing as to what should be the cost of products or services under improved conditions. Thus costing and cost control have different meanings and different objects in view. The aim of costing is cost determination, while the object of cost control is to reduce the cost of products or services. Despite this basic difference between the two, costing and cost control have much common ground because both of them utilize the same data for study, analysis, interpretation or compilation.

Cost control implies an attempt towards reducing costs of operations. It is supposed to provide an idea about the possible extent of reduction and to indicate the main lines along which cost reduction can be effected. Cost control seeks cost reduction in materials through a closer check on purchasing, store-keeping, handling and processing of materials. Reduction in labour cost is secured by competent supervision, better training and placement, improved methods and processes of production and satisfactory maintenance of equipments and working arrangements. Reduction in overhead expenses, whether factory or office, is sought through sound planning, organizing and directing efforts of management. In other words, cost control involves the maximum utilization of men, materials, machines and money, the thorough use of standardization, and the wise selection of relationship between volume of production and amount of overhead cost.

Like any system of control, cost control involves the establishment of different standards of control for the guidance of operations. The cost accounting system is suitable for setting appropriate standards in respect of materials and labour which are items of direct charges. But for indirect charges or overhead expenses, the system is not amenable to provide any satisfactory standards for control. Although some items of overhead expenses like steam and power generation or repairs and maintenance service can become the subject of standards, there remains a host of items for which no standard can be established. For purposes of effective control, the cost accounting system has to seek the aid of other control tools like budgetary control, break-even chart, profit and loss control, etc. As observed by Maddock, "Costing systems using arbitrary allocation of, *e.g.*, overhead expenses, produce costs which are arbitrary and approximate to that extent. To avoid this and to relate costs of overhead expenditure items to their recovery in selling prices, it is desirable to deal with the elements of cost involved

more by control against budgets, and by a recovery method, rather than by allocation".[1]

Elements of Cost. The total cost of production is composed of several items which may be stated as follows :

ELEMENTS OF COST

1. Direct Materials
2. Direct Labour
   — Prime Cost
3. Factory Overhead or Works Expenses
   — Factory Cost or Manufacturing Cost
4. Office Overhead or Administrative & Selling Expenses
   — Total Cost

The selling price of a product is obtained by adding some profit to the total cost of production. Costing is always done with reference to physical units into which the total production can be conveniently divided so as to establish definite quantity and identity of each part. product or service. Cost units vary between products, as well as between companies, such as quintals, kilogrammes, tonnes, kilometres, metres, litres, dozens, etc. Materials and labour costs may be classified into two categories, *viz.*, direct and indirect. Direct material costs involve expenditures on those materials which enter into the making of a product and the cost can be directly allocated to each unit of production. Indirect materials do not form part of the finished product but they are necessary for carrying out manufacturing operations, *e.g.*, refining materials, tallow, jute waste, grease, etc. Similarly, direct labour costs represent amounts paid to workers who devote their labour directly for the making of a product. Costs of indirect material and indirect labour along with other expenses incurred in the factory come under the heading of factory overhead.

Apart from factory overhead expenses, general expenses of administration and selling cannot be allocated directly to the units of production, and they also are referred to as overhead expenses. As these general expenses are incurred outside the factory in connection with the running of business as a whole, they usually go by the name of "office overhead". Overhead expenses, whether factory or office, become a significant part of the total cost, but they are accessary expenses of production as opposed to the direct expenditures on production. For this reason, overhead expenses remain more or less the same, irrespective of the varying quantities of production.

[1] Brech and others, *The Principles and Practice of Management*, p. 671.

Allocation of Overhead Expenses. Although total overhead expenses can be easily ascertained from financial accounting at the end of the period, the allocation of overhead expenses to various products immediately after the completion of manufacturing during the year poses a serious problem. The allocation is to be made on an estimate basis in such a way that the total overhead expenses are covered, on the one hand, and each product gets its proportionate and equitable burden of overhead, on the other. Herein lies the difference between direct and indirect expenses ; direct expenses are allocated on an actual basis, whereas indirect expenses are distributed on an estimated basis. Because of the varying nature of different items in overhead expenses and of the different products manufactured by a concern, several methods are available for distributing overhead expenses. Prime cost, factory cost and total cost are the three successive steps in cost compilation. Factory overhead expenses are usually allocated on the basis of prime cost or of its component items. Office overhead expenses are distributed on the basis of factory cost or manufacturing cost which is the summation of prime cost and factory overhead. The following are some of the important bases utilized for allocating factory overhead expenses :

1. *Direct materials cost*—A certain percentage of direct materials cost is adopted as the basis for calculation. Where the cost of materials constitutes the largest part of the prime cost, this method may be used. However, it is not a popular method.

2. *Direct labour cost*—Like the previous method, a certain percentage of direct labour cost is taken as the overhead burden for each product. When labour costs form an important part of the prime cost, it may be adopted for its simplicity.

3. *Prime cost*—As a basis of overhead cost distribution, it combines the principles of direct material cost and direct labour cost. Accordingly, it should be regarded as an extension of the previous two methods and it is subject to the shortcomings of both.

4. *Direct labour hour*—When labour cost is a significant part of the total cost, it may be employed for the allocation of factory overhead burden. The overhead expenses are divided by the total number of direct labour hours so as to get the amount of charge for each labour hour. But it does not differentiate skilled labour from unskilled labour, or an efficient from an inefficient labour. However, this method is used in a large number of cases because of its simplicity.

5. *Product unit*—Where the products are of uniform character and are confined to a few items, this method can be advantageously adopted. By adding necessary weights to the units of different products, a more satisfactory result can be obtained under this method.

It requires the distribution of factory overhead burden over the total units of production.

6. *Machine hour rate*—Where machines are extensively used in a concern, it may give a satisfactory result. The total expenses are divided by the total number of working hours of all machines so as to find out an hourly charge for machines. The expenses which have a bearing on the running of machines may be satisfactorily allocated under this method, but there are several expenses which are not at all connected with the working of machines.

7. *Departmentalization or production centre*—It is a refinement of the machine-hour rate. Instead of dividing the total expenses by the total machine hours, this method calls for the distribution of expenses over various departments or production centres which accommodate a group of machines. After departmentalization of expenses, the allocation can be made on the basis of machine hours of the individual departments. It is an effective method, but it requires extensive record keeping.

Fixed and Variable Expenses. From the standpoint of cost control, management is required to find out the fixed and variable expenses of the enterprise. Fixed expenses are static in nature, and they have no relation with the volume of production. Whatever might be the volume of production, they remain at the same level. On the other hand, variable expenses vary with the quantity of production, and they are directly related to the volume of production. It should be clear, therefore, that the greater the volume of production, the lower will be the unit cost of production, because fixed expenses can be widely distributed over a larger number of units. The computation of these expenses helps management in deciding upon the minimum volume of production that must be made to cover the total cost of production. This minimum volume is known as the 'break-even point' at which the income equals the outgo with no profit. Analysis of fixed and variable expenses enables management members to estimate profit possibilities at different levels of production and sale and to make competitive pricing and profitable product mix. With these ends in view, the technique of *cost-volume-profit* analysis has been developed.

Standards for Cost Control. In order to exercise effective control over the actual cost of production, the *standard cost* is established as a guide to action. The standard cost is set up from a careful study and analysis of completed cost spread over the past several years. The standard cost is adjusted from time to time to cope with changing circumstances. Once the standard cost is compiled, the actual per-

formance and present cost figures are compared with those of the standard cost. Any deviation from the standard is adjusted and controlled by the corrective action of management.

Besides the standard cost, there are two other standards for cost control, *viz.*, historical cost and estimated cost. Under *historical cost*, past accounting records of cost are used as standards for measuring current performances. Past or historical cost becomes a basis for comparing and evaluating future expectancies. The total cost per unit of output is usually split into elementary parts like direct materials cost, direct labour cost, factory burden and office burden so as to facilitate comparison between items of historical cost and actual cost. Because of its simplicity and easy availability, historical cost is widely used as a standard for cost control, but it suffers from a number of limitations. *Estimated cost*, as the name implies, is estimated or calculated from past experiences, present conditions as well as from future trends. As standard for cost control, estimated cost is the outcome of study, analysis and judgment on the part of managers and represents a realistic picture of the situation when carefully prepared. Briefly, in the absence of definite standards, the cost accounting system fails to act as a control device.

CHAPTER 15

SCIENTIFIC APPROACH TO MANAGEMENT

In the past, custom and tradition used to control business practices and methods. Devoid of any analytical study, research and experimentation, such customary practices of management were characterised by hidden tricks, mysterious clues and intuitive knowledge. As a result of these situations, management became traditional in character. An attempt was made subsequently for improving the knowledge over management work through a systematic collection of those traditional practices which were found to be the best available at that time. Traditional type of management was thus elevated to the status of systematic management. But still it was a type of management that depended upon the hit-and-miss guesswork for the solution of business problems.

In contrast to such "common sense" knowledge of management, the present century has witnessed the scientific approach to the problems of management, and the resultant growth of the management science. The scientific methodology of study, experimentation and observation has been applied for the evolution of this social science. Being the latest of all social sciences, management has become today the foremost social science with tremendous possibilities towards securing plenty, prosperity and peace in the globe. Management has thrown open, in the words of Urwick, "a new branch of human knowledge, a fresh universe of discourse." However, this science has been given various titles or labels like Taylorism, Rationalization, Productivity, Stakhanovism, and so on. To quote the same international authority on management again, "these synonyms are escape mechanisms, efforts to cobble holes in shirts before all the stuffing has run out of them."[1] Strictly speaking, Taylor's scientific management, rationalization and productivity are nothing but different facets of management. It is management alone which provides a full body of knowledge for the complete guidance of human efforts in any social institution. With this understanding, the nature and purpose of scientific management, rationalization and productivity may be studied here as they are commonly known.

SCIENTIFIC MANAGEMENT

The genesis of scientific management was laid down by Frederick W. Taylor in the U. S. A. towards the close of the nineteenth century.

1 Urwick, L. F., *The Patterns of Management*, p. 3.

and it was his genius which provided a new body of knowledge called "scientific management." The principles of scientific management were made to take a tangible shape and a concrete form through the publication of his famous work, *the Principles of Scientific Management*, in 1911. Although the work was professed to contain some general principles of management, it was in reality found to be a treatise on factory management or production management.

In its essence, scientific management demands a complete mental revolution and rethinking on the part of working and management personnel. It calls for the substitution of rule-of-thumb methods by their vastly improved counterparts through an analytical study and observation of all affairs in the concern. To replace guesswork, hunch or intuition in matters of management by an objective appraisal of facts and a correct measurement of situations, scientific management calls for the application of a two-fold technique. The first aspect of the technique lies in the discovery of the best method for discharging work responsibilities in all spheres of the undertaking. For developing these basic methods, scientific management lays a great stress on time and motion study which is regarded as "corner-stone of scientific management." Methods that are established by the scientific process of study and observation have been designated by Taylor as "the laws of managerial situation". The second aspect of the technique centres round the fruitful use of such methods in utilizing the material and human resources of the enterprise. On its material side, scientific management deals with planning and control in regard to materials, machines and other facilities. By the application of basic methods, well-thought-out procedures and control standards are to be established in all phases of work. On its human side, scientific management is concerned with the development of a teamwork and a harmonious relationship between labour and management. In hiring, firing, compensating, placing or transferring workers, it demonstrates the importance of fair play and justice ; it advises the abandonment of all forms of favouritism and bias in personnel matters. In addition, scientific management calls for establishing a correlationship between rewards and efforts, and for studying the reaction or response of workers to rest pauses and better working conditions.

The object of scientific management is to secure the maximum prosperity of both the employers and the employed. For the employers, the maximum prosperity rests on the development of all business activities to their highest state of productivity, and for the employees, the maximum prosperity lies in the development of all workers to their highest state of efficiency through correct selection, appropriate training and judicious placement of workmen. Scientific management asserts that prosperity of one party does not mean adversity of the other party. It

points out that interests of workers and owners are not antagonistic in character, but they complement each other and are mutually dependent. Production being a complex of labour, capital, management and other factors, any such activities cannot be carried out without the support and co-operation of each of the factors. All the factors are compensated from the joint pool of income made by the business. It is evident, therefore, that no party can get an increased share of income unless the income itself is large enough for the purpose. To put emphasis on this aspect, Taylor pointed out that "both sides should take their eyes off the division of the surplus as the all-important matter, and together turn their attention towards increasing the size of the surplus."

Principles of Scientific Management. Principles of scientific management may be stated as follows :

1. Determination of each man's work on a scientific basis in replacement of the usual rule-of-thumb method or the traditional practice.
2. Selection, placement and training of workers on a scientific line for increasing their efficiency, dexterity and loyalty.
3. Co-operation between labour and management through the exercise of managerial leadership, communication and supervision.
4. Division of work and responsibility between management and labour by way of allocating "planning functions" to managers and allowing workers to concentrate on "doing functions."
5. Guidance of human efforts through issuing orders, instructions or making rules under a system of functional foremanship in place of the prevailing line authority.
6. Extensive use of time and motion study for eliminating unnecessary motions and operations, for relieving fatigue and exhaustion of workers and for setting standard time for the completion of each job.

Taylor's principles of scientific management amount to some new duties placed on management, not principles involving the establishment of fundamental laws for the purpose of guiding and controlling human efforts in any organization. Even in the statement of these duties, certain misconceptions have crept in. It is the analytical search for methods that has bestowed upon Taylorism a unique place in the industrial world, that has crowned Taylor with a matchless jewel, and that has earned for his philosophy a public recognition. And in other respects, the concepts of scientific management have not stood the test of time.

Features of Scientific Management. Taylor's scientific management has been amplified and restated by his followers for making a methodical presentation of its basic elements. The following are the salient features of scientific management :

First, scientific management calls for the collection of all factual information and statistical data affecting the operation of a business enterprise.

Secondly, it demands the screening of strategic facts and situations from the myriads of data collected, and the formulation of "laws of managerial performance" based upon such facts.

Thirdly, it requires the establishment of various standards of work performance in regard to time, quantity, quality and cost for exercising effective control over the operations.

Fourthly, it makes out a case for undertaking planning before doing. All matters like when the work is to be undertaken and completed, how the work is to be sequenced through different stages, and what materials, equipments or personnel are to be used in the work, must be settled through advance planning.

Fifthly, it involves extreme specialization and functionalization of activities for accurate job determination, correct placement of personnel and increasing the efficiency of workers.

Sixthly, it entails work simplification and methods standardization through time, motion and fatigue studies for improving the productivity of industrial concerns.

Lastly, it calls for the establishment of rules for regulating the conduct of human beings as well as the elaboration of procedures for developing teamwork and securing harmonious operations.

Taylor's Functional Foremanship. Before the development of staff concept in matters of authority delegation, Frederick W. Taylor propounded the so-called functional foremanship in replacement of the prevailing line authority. Under line authority, all orders and instructions pertaining to an area emanate from one line manager who is held accountable for divergent duties thereof. Taylor felt it impossible to acquire the varied knowledge and experience required for discharging such duties on the part of line managers, particularly at the supervisory level. Taylor's scientific management being confined to factory management, it was believed that one foreman or superintendent could not manage the different aspects of production work for guiding the workers. To improve the efficiency of production work, Taylor suggested the replacement of one line manager (foreman or superintendent) by eight functional specialists who would give orders in regard to their individual specialized functions. The work of one gang boss or line manager would have to be subdivided among eight specialists—(*i*) route clerk, (*ii*) instruction card man, and (*iii*) time clerk engaged in planning work ; (*iv*) gang boss, (*v*) speed boss, (*vi*) inspector, and (*vii*) repair boss engaged in the execution of plans ; and (*viii*) a shop disciplinarian for the maintenance of discipline and morale of workers.

This concept of functional foremanship has been found to be unrealistic and dangerous, and it has not been applied in actual practice. It violates the unity of command which is one basic principle of management. There was serious shirking of duties on the part of workers, and confusing or contradictory orders were issued by different specialists.

Criticisms of Scientific Management. Taylor's scientific management is no longer revolutionary or fascinating in character. In its beginning, scientific management inundated the whole industrial world in a sudden flood, and it became a fad with many people. Gradually, however, it has receded into the background. Under modern conditions, it has been put into cold storage. And Taylorism has become a dead cult now for certain misconceptions.

1. The use of the word "scientific" before management is inappropriate and unfortunate. What is implied by scientific management is nothing but a "scientific approach to management". As Mr. Brech has aptly observed, "In an era that has not seen only the best of science, it was perhaps an unfortunate choice."
2. The principles of scientific management provide certain concepts of factory management or production management, not management of the whole enterprise with all its functions. Sales management, finance management, etc. do not find any place in scientific management. But management in such areas of the business is vital for the existence of an enterprise. Taylorism primarily centres round the management function pertaining to the complex manufacturing operations for a large-sized enterprise.
3. Taylor's advocacy for separation of planning from doing is a misleading idea. Planning for a utopia may be unconnected with doing, but planning for performance must be closely related to the doing functions in business. Planning and doing are the two halves of the work process ; neither of them can be neglected in the discharge of work responsibilities.
4. Taylor propounded the concept of functional foremanship for overcoming the defects of line authority. But the adoption of functional foremanship in organizing works department would create havoc and disaster in the industrial world. Even the enthusiasm of Taylor's ardent supporters was chilled to see the baneful results of functional foremanship in those few cases where it was applied. The idea of functional foremanship was buried for good after a short while.
5. Scientific management has proved itself to be unscientific so far as workers are concerned. For speeding up work and increasing efficiency of workers, the job of human beings was made as mechanical as possible by breaking a task into its elementary components.

Any job which does not require any intelligence and thinking on the part of operators cannot be done satisfactorily by human beings. Such mechanical job can be done by machine, not by rational human beings. Briefly, Taylor ignored the limits of specialization.

6. Scientific management has been opposed by both the employers and employed for whose benefit this new philosophy has been designed. An all-round opposition implies that scientific management could not show any tangible benefits to the parties. No matter whether it provided intellectual satisfaction to the followers of Taylor or whether it yielded any intangible benefit, the oposition of workers and owners goes against the credit of scientific management.

Commenting on Taylorism, Dr. C. S. Myers has observed that "It is unscientific because obviously no accurate information is available upon which the amounts to be deducted for the allowances made can be based. It is anti-social as it aims at excluding as far as possible the average workman. It is unpsychological since it is a measure of rate of work obtained under abnormal condition and in circumstances that cannot fail to arouse an undesirable mental atmosphere throughout the factory."

RATIONALIZATION

Rationalization as a method of industrial reorganization was initiated in Germany to reconstruct her industries that were devasted during the First World War. The measures adopted to achieve the desired objective were so novel and captivating that they came to be recognized as a new philosophy of industrial regeneration, which has been precisely termed as "new industrial revolution." The phenomenal success of German industries within a short period of this rationalization drive awakened the industrialists of other countries to the realities of the situation. Moreover, when it was found that the rationalization drive steered the German industries clear of the stress and strain of the great economic depression, other countries had to answer the challenge of technical efficiency and superiority that was thrown by the Germans. By the application of the principles of rationalization, Japan made a rapid progress so as to take an important place in the industrial map of the world. England and other countries followed suit in the adoption of the rationalization drive. It was the U.S.A. that only stayed outside this drive of rationalization. But even that country was not free from its influence, and the prevailing concept of scientific management was modified in that country in the light of this new industrial philosophy.

Nature and Meaning. The term 'rationalization' is derived from the word rational which means an act endowed with reason. The only

rationale on the part of industrialists is to secure the highest industrial efficiency, or to put it reversely, the lowest unit cost of production. The World Economic Conference of 1927 defined rationalization as "the method of technique and organization designed to secure the minimum of waste, either of efforts or of material." In amplification of this definition, the Conference further observed that "rationalization includes scientific organization of labour, standardization of both materials and products, simplification of processes and improvements in the system of transport and maketing." Rationalization implies an all-round improvement in the industrial affairs based on sound judgment and reason in place of prevailing industrial methods and practices derived from tradition and custom. Rationalization is not only concerned with securing internal economies within the enterprises, but it counts on external economies as well through industrial co-operation and combination. This aspect has been emphasized by D. H. Macgregor who says : "to rationalize an industry is to remove all the duplication and overlap which can be avoided, and to achieve as much unity of purpose as is practicable without loss of economy."

Urwick defines rationalization in the like manner of scientific managent as 'both an attitude and a process'. "As an attitude it records the belief that a more rational control of world economic life through the application of scientific methods is possible and desirable. As a process it implies the application of the methods of science to all problems arising in the organization and conduct of production, distribution and consumption". Rationalization supersedes scientific management in its social objectives. It wants the maximum economic prosperity of all concerned ; it professes to look after the interests of the consumers and tries to eliminate the social wastes attendant upon trade cycle swings of prices.

Rationalization and Scientific Management. As a method of industrial organization, both scientific management and rationalization imply the replacement of antiquated practices by scientific methods for the solution of industrial problems. Both are equally concerned with the technical improvement and the technological progress. But despite this common ground, there is a lot of difference between the two. Rationalization differs from scientific management in the following respects :

1. *Industrial co-operation*—Rationalization is the genus of which scientific management is a species only. Scientific management confines its activities to a single industrial enterprise and tries to avoid wastes within the concern through closer co-operation between employees or between departments. Rationalization, on the other hand, embraces all the enterprises of an entire industry in its scope. It aims at the elimination of waste throughout the industry by seeking co-operation from all

allied or associated concerns. Unlike scientific management, no measures of rationalization can be introduced piecemeal in one unit of an industry, leaving the other units unaffected.

2. *Industrial combination*—Combination of industrial enterprises is an integral part of rationalization. It cannot secure many of its objectives without rooting out business rivalries and business jealousies. Scientific management has nothing to do with industrial combination and tries to improve matters on an individualistic basis.

3. *Adjustment of capacity to demand*—With a view to steadying prices, rationalization attempts at eliminating wasteful competition in various ways. It may eliminate weak and inefficient units through combination, place direct restriction on output, or adopt common arrangement in purchasing materials, selling goods and in undertaking research. It can make better co-ordination between demand and supply of goods through seeking industrial co-operation and combination. But scientific management cannot save the concern from ruthless competition, and the total production of an industry remain unaffected by the unilateral action of an enterprise adopting scientific management.

4. *Standardization and simplification*—Scientific management can at best make unit-wise improvements or innovations in products. Thorough standardization and simplification of products are beyond its reach. To reduce the cost of production and the selling price of goods, rationalization reduces the superflous varieties of goods and simplifies the existing products for giving benefits to consumers. Moreover, rationalization brings about standardization of products, processes and materials.

5. *Coverage of problems*—Scientific management is mainly concerned with the scientific organization of labour and management for the solution of productive problems. But rationalization is very broad in its approach ; it covers all problems of production, finance and marketing along with advertising and transport.

6. *Promotion of new concerns*—The principles of scientific management are applicable to an industrial unit that has already come into existence. But the philosophy of rationalization covers the initiation of an enterprise. Rationalization is not only limited to the reorganization of existing units, but it includes the principles of scientific location, optimum size, proper capitalization and planned layout as well.

7. *Social objective*—Scientific management is concerned with the well-being of employees and employers of a single concern. Rationalization goes much further in that it seeks the welfare of the consumers as well as that of the entire community. It must justify its existence by benefiting the community or humanity as a whole. The consumer has to be provided with quality goods at lower prices. For the general community, it has to ensure a greater economic stability and a higher

standard of living. Rationalization has the objective of "the greatest good to the greatest number", whereas scientific management is concerned with the greatest good to the limited number who may be the employers alone, or both employers and employees.

Advantages of Rationalization. Because rationalization implies combination and enlargement of size of business units, it carries at once all the advantages of combination and of an optimum business unit. To avoid needless repetition, the advantages are stated briefly as follows :

1. Rationalization brings about stability and sobriety in industry through the avoidance of destructive competition. Production is controlled in accordance with the demand of the community so as to do away with the havoc of trade cycle.
2. Rationalization ensures better utilization of human efforts and avoids all possible wastes thereof. Scientific selection of workers, proper placement, suitable training and judicious allocation of task are amply rewarded by greater productivity.
3. Productive processes, equipment and materials are all standardized for the purpose of avoiding wastes and for making them conform to the production of quality goods.
4. Finished products are standardized within a narrow range, and they are simplified as far as practicable. As a result, consumers are benefited by way of improved quality, reduced selling price and a greater purchasing power. Mass production is facilitated and technical improvement is encouraged. Marketing becomes cheaper and the fear of unsold goods is eliminated.
5. The cost of production is reduced to a greater extent by the adoption of specialization and mechanization in the production of goods. Regional specialization between plants may bring about further economies in transport cost and other marketing expenses.
6. It permits the pooling of technical knowledge, trade secrets and research developments among several units. The spirit of jealousy is replaced by healthy co-operation among the concerns.
7. Rationalization leads to the prosperity of the entire community. Producers secure larger and steadier profits, workers enjoy higher wages and more stable employment, consumers get lower prices and better quality, and the community is benefited by the effective utilization of resources and avoidance of wastes thereof.

Difficulties of Rationalization. The first difficulty appears in connection with the pricing of goods. Goods may be priced by a rationalized industry to derive monopoly profits, and consumers may be exploited in spite of the low cost of production. The supply of goods being controlled by one agency, there is no guarantee that

business enterprises in the private sector would be guided by a motive of public welfare. However, this difficulty can be overcome through the regulation of prices by the public authorities or through direct Government interference.

The second difficulty lies in the opposition of producers ; they may resist rationalization on account of ignorance, conservatism or the necessity of additional investments. It is also contended by some employers that once rationalization is adopted as a method of industrial reorganization, it would require continuous additional investments to keep pace with the progress of time and technology. This difficulty does not appear to be a formidable one ; the businessmen should be taught to accept the view that for holding their position in business, and even for the survival of their enterprises, they have no alternative but to introduce rationalization.

Rationalization may make the size of the unit too gigantic for effective management. Executives who can direct the affairs of such a business are rare, and consequently the efficiency of a rationalized industry may suffer for want of suitable top executives. Poor co-ordination in activities of such enterprises often results in the emergence of top-heavy administration for neutralizing the prime benefit of lower costs of production.

Rationalization is inseparably linked up with labour hostility and labour unrest. The opposition of workers is based on the threat of unemployment which could not be eliminated as yet. This threat of unemployment does not suggest the abandonment of rationalization, but it raises the problem how "rationalization without tears" can be carried out. Through a phased programme of rationalization spread over a period, these objects can be secured. Rationalized industries through their greater productivity would be in a position to absorb the surplus workers of the existing concerns. Nevertheless, it cannot give the necessary consolation to workers who may be steeped in poverty, debt, unemployment and distress for the time being. Although workers may be employed in the long run, they may not survive for want of means up to the long period to get back their promised employment. The avowed ends of rationalization would remain meaningless unless it can cure the ills of unemployment, whether temporary or permanent.

Last but not the least, another difficulty is encountered with the availability of requisite finance. Lack of funds has prevented the enterprises of our country from adopting the desired rationalization measures. As a matter of practical importance, the requirement of enormous funds has regulated the pace of rationalization.

RATIONALIZATION IN INDIAN INDUSTRIES

Rationalization in its full sense has not been applied in our country.

Rationalization is taken to be tantamount to modernization or replacement of equipments in popular parlance. Here and there some attempts have been made in the past to introduce comprehensive schemes of rationalization, but with no satisfactory results. However, the recent productivity drive is giving a fillip to rationalization. Although cement and steel industries can boast of rationalization, yet the personnel problem, layout problem, research problem and other problems in regard to optimum size, utilization of by-products, standardization of products and materials have not been tackled suitably. The four industries where rationalization has become an urgent necessity may be studied in greater details.

Jute industry—The virtual monopolistic position of the jute industry has been lost with the growth of jute industry in Bangla Desh and with the development of jute substitutes in foreign lands, and the problem of rationalization has come to the forefront. The I.J.M.A. has succeeded in restricting the output of the industry and has initiated vigorous research in raw jute and jute products. Nevertheless, the jute industry can only be saved from the devastating foreign competition through modernizing its equipments. Its machines and equipments have become outdated and stand no comparison with the latest equipments of its competitors. It was estimated in the early fifties that a total fund of Rs. 45 crores would be required to carry out the modernization programme spread over a period of 15 years.

Of this amount, a sum of Rs. 15 crores was estimated by the *ad hoc* Committee in 1959 to have been spent by the industry over the last ten years. With the financial assistance available from the National Industrial Development Corporation as well as with their own retained profits, the jute mills have almost completed their programme of modernizing the spinning section and carried out about 75 per cent of the modernization programme in the weaving section by 31st March, 1964. Since February 1963, the N. I. D. C. has been prohibited from granting loans to jute industry for modernization purpose. The N I. D. C. sanctioned Rs. 7.5 crores as loans to jute mills for modernizing equipments.

Cotton mill industry—The Technical Sub-Committee of the Working Party for Cotton Textile Industry pointed out in 1950 that its equipments were too old and obsolete for any economical working of the mills. The cotton mills would face a crisis unless immediate steps were taken to modernize their equipments with the object of increasing productivity, reducing cost of production and improving quality of the product. Prof. M. P. Gandhi estimated in 1954 that the total amount required for modernization would come to about Rs. 300 crores, out of which Rs. 60 crores only might come from the reserves of the cotton mills. Subsequently, various estimates point out that the amount required would come to the order of Rs. 400 to 500 crores. The

N. I. D. C. was rendering financial assistance to the cotton mills for carrying out their modernization programme up to the end of January, 1963. Out of the sanctioned amount of Rs. 19.7 crores, a sum of about Rs. 11 crores was disbursed up to March 31, 1970. Some progressive concerns have already introduced new equipments in their preparatory and finishing sections and to a lesser degree, in the weaving section. Up to the end of June 1973, 103 sick mills were taken over by the Government and their functioning is being supervised by the National Textile Corporation set up in April 1968.

During the last war exigencies, the products were compulsorily standardized and simplified to some extent. But the measure proved to be a short-lived one because of the lack of co-operation on the part of cotton mills. By a certain amount of co-operation and combination, many maladies of the cotton mills industry can be removed and resultant benefits obtained. For example, the optimum size, standardization of products and materials, common arrangements for purchasing materials or marketing goods, specialization between plants or regions, market research for design or style, and regulation of output can be effected by combination and co-operation on the part of cotton mills.

Coal industry—The coal industry was characterized by the existence of many scattered units of uneconomic size, and such small units were compelled to use the crude method of exploiting minerals without any mechanical aid. As a result, both the quantity and quality of production did not come to a satisfactory level. The coal industry being a pillar to the development of other industries could not be allowed to go in this way. Accordingly, the Government took over the coking coal mines in 1972 and the non-coking coal mines in 1973 and the nationalized coal industry has been placed under the management of the Coal Mines Authority Limited and its many subsidiaries including Bharat Coking Coal Limited. Several other steps have been taken for improving the working of coal industry. Washing of coal has been introduced to prevent wastage ; metallurgical coal is being conserved by checking its indiscriminate use for all purposes. The Fuel Research Institute has been set up at Dhanbad for improving the products and processes ; it is entrusted with the task of finding a better use of inferior coal. Sand stowing and other necessary safety devices have been adopted to prevent accidents in collieries. The Coal Mines Labour Welfare Fund Act of 1947 and the Coal Mines Provident Fund and Bonus Schemes Act of 1948 are designed to improve the lot of colliery workers. In order to increase the degree of mechanization in coal extraction, the Coal Mining Machinery Plant has been established at Durgapur with Soviet assistance.

Sugar industry—The sugar industry thrived on protection which has been subsequently withdrawn. Nevertheless, it is still enjoying informal

protection because of the serious import restriction. The sugar industry would be forced out of existence if it is allowed to face the full blast of foreign competition. The cost of production is very high in comparison with other countries. It is an unfortunate state of affairs that the sugar industry could not show a better performance even after three decades of its establishment. The cost of production is said to be high because of the poor quality of sugarcane, non-utilization of by-products, the use of outdated equipment and the small size of the units. Attempts have been made to grow a better quality of cane, and at present more than 80% of the crop land is planted with improved varieties so as to increase the yield per acre. Bagasses are now used for making paper boards, and molasses are being utilized for making alcohol and liquid fuel. The Institute of Sugar Technology and Sugarcane Research was set up in 1952 to carry out research work for the sugar industry.

The Indian Sugar Mills Association stated in its memorandum before the Shroff Committee that the total amount required for modernizing the equipments of sugar factories would come to Rs. 28 crores, out of which half the amount may be met by self-financing. Recently, the development council for the industry has estimated that the cost of replacing equipments would come to Rs. 60 crores. In the replacements of its assets, the sugar industry is lagging behind other industries. Steps should be taken for the rapid modernization of its equipments. Although the N. I. D. C. was not giving any financial assistance to the sugar industry on this account, working reports of the Industrial Finance Corporation disclose that sugar factories are getting financial assistance from the I. F. C. for modernization purposes.

PRODUCTIVITY

Nature and Meaning. Productivity is the ratio between input of resources and output of products. The resources that are put in for the production of goods and services include the contributions of men, money, machines, materials and management. The aggregate or complex of such contributions produces certain results in the form of goods and services. Productivity centres round the relation that exists between the aggregate contributions of all factors of production, on the one hand, and the results produced by the factors in combination, on the other. Accordingly, productivity and production have different meanings as well as different objects in view. Production is concerned with end results of factors' contributions in the shape of volume, value or quantity of goods and services turned out by an establishment. In contrast, the productivity views the volume or value of production in relation to resources utilized in the making of such goods and services.

The large volume of production has no connection with a high rate of productivity; and they may not go hand in hand in all cases.

Increased production is brought about by making larger capital investments and employing additional men. But increased productivity is only possible through the making of larger production by the use of lesser capital investments and smaller number of men. That is to say, productivity is concerned with the efficiency of production and appraises production plant-wise, industry-wise, region-wise or country-wise throughout the industrial world.

The resources that are put in fall into two distinct categories—material resources and human resources or inanimate resources and animate resources. Material resources in the form of plants, equipments, machines and raw materials are mere slaves to the amount of capital investments. By increasing the amount of capital investments, better machines and larger materials can be acquired for securing a greater volume of production. But productivity is not likely to be improved by injecting additional doses of capital in all productive processes. Since productivity means, in actual terms, the relation between the cost of production and the value of output, additional capital investments do not result in higher productivity everywhere. In other words, material resources are subject to the laws of mechanics, and they cannot have any greater output than what their input warrants. The larger the input, the greater will be the output without causing any improvement in the ratio between inout and output. Briefly, the contributory capacity of machines and materials is more or less fixed and rated. Beyond the fixed limit, productivity falls flat. In contrast, human resources offer an opportunity for tremendous growth and development. Under conductive conditions, the human beings by their unfettered force of will-to-do can raise productivity to an amazingly high level, but the same group of human beings can pull down productivity by their deliberate fettering of human energy. Hence, the key to increased productivity lies in the utilization of human resources in the best possible manner. And this trigger to human energy is held by sound management.

Productivity involves a balance between factors of production in such a way that maximum results are obtained from the use of minimum resources. Such an objective of maximum results at the cost of minimum resources must be the aim of any industrial philosophy, whether it is scientific management, rationalization, Stakhanovism or the like of such drives that may be designed in future. True to their meanings, these drives are partial and temporary expedients for pushing the workers towards greater performance. Management science has been parcelled out to make the existence of so many separate movements, drives or philosophies. But no such attempt can bring about higher productivity without the support of management. "No ideology, no 'ism', no political theory can win a greater output

with less effort from a given complex of human and material resources, only sound management. And it is on such greater output that a higher standard of life, more leisure, more amenities for all must necessarily be founded."[2]

Measurement of Productivity. The efficiency of an industrial enterprise can be tested by measuring its productivity. But no suitable yardstick has yet been devised for this purpose. The concept of contributed value has been developed for measuring productivity. Like any device of measurement, quantitative factors can be measured by contributed value, not the qualitative factors. Under this concept, the total cost is divided into two parts, *viz.*, the cost of those resources which are obtained beyond the enterprise and the cost of resources within the command of the enterprise. From the total value of the final product, the cost incurred for acquiring outside resources is deducted for obtaining the value contributed by the enterprise itself. That is to say, contributed value is the excess of the selling price over the cost of materials and services paid to outside suppliers.

Because of the difficulties of measuring aggregate productivity, productivity of one of the important factors of production like land, capital or labour is found out. Although the output can be measured in terms of number of units produced or money value of sales and services, it becomes difficult to measure the input of dissimilar and varied resources. Accordingly, productivity without qualification implies labour productivity in popular parlance, because labour saving affects costs, prices, wages and levels of living. Labour productivity is measured in terms of man-hours of labour. But this measurement has a number of difficulties. (*a*) No distinction between skilled and unskilled labour is possible. (*b*) The fact that labour productivity is the cumulative results of all factors is ignored. (*c*) Labour being plentiful in comparison with land and capital in underdeveloped countries, this measurement of productivity is not indicative of the correct situation.

Importance of Productivity Analysis. Productivity indices are looked upon as the barometer of a country's economic and industrial advancement by way of comparing the economic changes made between periods and indicating the prospects for the future. They assist in the formulation of policies by the Government, business houses, and labour unions in respect of prices, employment, wages and hours of work. They are also extremely helpful in national planning for providing information as to the comparative efficiency of different units of an industry both within and without the country.

2 Urwick and Brech, *The Making of Scientific Management* (Vol. II), p. 224.

On the national level, the productivity studies help in estimating degree of protection to be granted to an industry, in formulating the taxation and fiscal policies of the Government and in extending the labour welfare schemes. At the enterprise level, the productivity indices are utilized for evaluating the effectiveness of various schemes of rationalization, innovation or technical improvements.

Tools of Productivity. The following are the important tools of increased productivity :

1. Scientific management techniques and practices, including training for all levels of management.
2. Work, time and motion study for scientifically determining better and quicker ways of doing the job and streamlining the operations.
3. Human relations, including modern concepts of industrial relations, wage and bonus incentives, collective bargaining, management-worker consultation, workers' education and labour welfare.
4. Simplification, standardization and specialization.
5. Control techniques, including production planning and control, cost control, inspection and quality control, process planning and stock control.
6. Determining improvements in plant layout, working conditions and materials handling.
7. Selection and training of personnel, including the operatives as well as the various levels of management.
8. Industrial research, in plants and laboratories, for continuous improvements in products and processes.

Contributories to Productivity. Many and varied are the contributories to productivity. Enumeration of all contributories and determination of their individual share of contribution to overall productivity are almost impossible because of the composite and integrated character of contributories. Some of the important contributories may be stated as follows :

1. *Technological advances*—The major break-through in industrial productivity was first made at the time of industrial revolution through technological advances. Since then, continuous study and research have resulted in adopting thorough mechanization, standardized mass production and automation for accelerating the pace of industrialization. The experience of the industrial world shows that technological advances make significant contribution to industrial productivity by way of cost reduction, greater production, lesser rejection and quality improvement.

2. *Supply of capital*—Financial resources add to make spectacular advances in industrial productivity in a number of ways. Innovations in products or processes, installation of latest machinery and equipments, adoption of an integrated flow of continuous production, introduction of mechanical devices for materials handling and attainment of optimum sizes call for investment of funds on an expanding scale. Productivity

differentials between developed and underdeveloped countries can be mainly ascribed to the relative abundance or shortage of capital.

3. *Quality and availability of raw materials, fuels and water*—Productivity differences between countries arise from the nature and extent of resources endowment. Natural resources like water, fuel and raw materials are the essential input in the production complex and the output becomes as good as the quality of input warrants. Apart from quality, the availability of local resources leads to greater productivity by ensuring stable, economical and quick supply of such facilities.

4. *Skill and efficiency of labour force*—Contribution of labour force is so important to productivity that a separate labour productivity is compiled in many cases. In between the human resources and material resources, human resources are far more important determinant of industrial productivity and they have no fixed rated capacity like the material resources. For stepping up productivity, the skill and efficiency of labour force are material considerations. Skill and efficiency depend partly upon the training and morale-building arrangements and partly upon the climatic condition and social systems of the country and the standard of living and literacy of workers.

5. *Managerial ability*—The key to industrial productivity is held by sound management. Through the adoption of far-sighted planning, dynamic organizing, inspiring leading and enlightened controlling, the managerial ability plays a crucial role in transmuting resources to higher productivity. The basic cause of higher productivity in American industry is to be found in the progressive development of managerial ability rather than the development of capital formation or other like contributories. The relationship between productivity and management is so direct and close that many regard the productivity movement as a synonym of management development.

6. *Economic and political environment*—Industrial enterprises do not operate in a vacuum and the nature of favourable or unfavourable environment is reflected in their operations. Economic conditions of the country determine the size of the market and dictate the scale of production and the degree of industrialization. Transport and communication system, electricity generation, storage and service conditions and credit facilities make up the necessary economic environment for raising industrial productivity. Political environment is created by taxation, tariff, financial and industrial policies of the Government, and these policies exert tremendous influence on productivity by encouraging the adoption of the latest technique of production, urging the development of comparative efficiency through healthy competition, and generating the flow of savings for industrial investment.

Productivity Movement in India. On the invitation of the Government of India, two I. L. O. Missions visited the country in 1952 and 1954. The team of experts examined the working of different industries in Bombay and Calcutta regions and submitted reports to the Government on the state of productivity of Indian industries. In 1956, a productivity delegation under the leadership of Dr. V. A. Sarabhai was sent to Japan for making on-the-spot study of productivity techniques and methods in that country and for recommending suggestions to the Government on the formation of productivity centres in India. The Productivity Delegation on its return submitted a report in March, 1957 and recommended the establishment of a National Productivity Council. After getting the issues examined by a seminar on productivity in November, 1957, the National Productivity Council was registered as an autonomous association in February, 1958. The N. P. C. is intended to assist in the formation of local and regional productivity councils, to make the industrialists productivity conscious, and to look after a steady improvement in quality of products. The membership list of the Council has been limited to sixty drawn from representatives of industrialists, workers, Government and other interests.

A programme for the productivity has been chalked out at the first meeting of the N. P. C. held in March, 1958. The programme consists of the following eight points : (*i*) arousing and stimulating interest in productivity through the spread of information ; (*ii*) training in productivity techniques at all levels of management ; (*iii*) providing specialist services to the local councils ; (*iv*) encouraging inter-plant visits to the mutual advantage of visitors ; (*v*) undertaking research into the ideas of productivity ; (*vi*) sponsoring foreign tours of productivity teams for enriching the country's experience in productivity ; (*vii*) arranging foreign training in productivity ; and (*viii*) inviting foreign technical and productivity experts for assistance and guidance towards increased productivity in India.

At the end of ten years of its existence, it has been stated that N. P. C. has not got into the heart of the industry as yet and the core of the industry still remains untouched. Up to the end of March, 1967, six Regional Directorates and about fifty local productivity councils have been set up in the country. Moreover, several productivity teams have been sent abroad, training programmes have been organized and specialist services have been arranged at Regional Directorates. For stepping up the productivity movement, the year 1966 was observed as the productivity year.

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 12 : OPERATING ORGANIZATION & STRUCTURAL FORMS

1. What do you mean by departmentation in organization? State the distinctive features of departmentation by function, product and territory.

*2. What is meant by "delegation of authority"? Explain the benefits and difficulties of delegation.

*3. State the nature of delegation. Discuss the principles and practices for effective delegation.

*4. Explain with the help of diagrams that the functional organization structure stands for greater centralization and the divisional organization structure accounts for greater decentralization. Briefly indicate the advantages of decentralization.

*5. Explain the different types of authority relationships that bind the specialized parts of any enterprise as one co-ordinated whole. Point out the difficulties of maintaining a harmonious line-staff relationship.

*6. Analyse the merits and defects of line and staff organization.

7. What is the role of committees in an organization? What are the reasons for creating committees in the organization and what are the shortcomings of committees?

CHAPTER 13 : THE PROCESS OF PLANNING & CONTROL

8. Discuss the nature and scope of planning in business.

9. "Control is to see that events conform to plans." In the light of this definition, state the important steps in control.

CHAPTER 14 : TOOLS OF CONTROL

10. Explain the use of ratios in financial analysis. State how major ratios on the current business position are calculated.

11. What do you mean by budgetary control? State the advantages of budgetary control in a business.

12. Discuss briefly the various types of budgets a business needs for introducing a complete budgetary programme.

13. What are the usual bases utilized for allocating overhead expenses in costing?

14. Explain the significance of analysing fixed and variable expenses in costing and of setting standards for exercising cost control in any enterprise.

CHAPTER 15 : SCIENTIFIC APPROACH TO MANAGEMENT

*15. Explain the principles of scientific management, as enunciated by F. W. Taylor, with special reference to his functional foremanship.

*16. Discuss the nature of scientific management with reference to its basic features. State the benefits and criticisms of scientific management.

17. How does the philosophy of scientific management differ from that of rationalization? Explain fully.

18. What do you mean by rationalization of industries? State the important advantages of rationalization.

*19. Discuss the difficulties of rationalization with special reference to Indian industries.

20. Discuss the need for, and the importance of rationalization in any one of the following Indian industries—(*a*) cotton textile industry, (*b*) jute mill industry, (*c*) coal industry, and (*d*) sugar industry.

*21. Explain fully the meaning and importance of productivity in industry. Discuss how increased production differs from increased productivity.

*22. Discuss the important contributories to productivity.

23. What do you know of the productivity movement in India? Mention the progress achieved so far in this respect.

PART SIX—FINANCING ACTIVITIES

CHAPTER 16

THE CORPORATE CAPITAL STRUCTURE

The term "structure" means the manner of building as well as the arrangement of parts in any building work. To construct a residential building, the size of the structure and the materials to be used in constructing it are obvious considerations, and they are to be determined beforehand. Likewise, for the erection of the capital structure, the size or amount of the structure and the composition or character of it become the two primary considerations.

The term "capital structure" has been used in two different senses by different authorities on corporation finance. According to one view as represented by Gerstenberg,[1] capital structure means the composition or make-up of the amount of long-term financing, while the amount of long-term financing in the form of shares, debentures, bonds and other similar borrowings is to be called "capitalization". But in the opinion of many others, the terms "capitalization" and "capital structure" mean the same thing involving the quantitative and qualitative aspects of the structure. Husband and Dockeray citing the opinion of several authorities conclude that capitalization "embraces the composition or character of the structure as well as the amount."[2] In fact, the amount and composition of the capital structure complement each other and are mutually dependent.

AMOUNT OF CAPITALIZATION

The amount of capitalization represents the aggregate sum that is secured by a company from its ownership capital and long-term borrowings. The ownership capital is composed not only of the share capital of a company, but of its revenue and capital reserves as well. The ownership capital is equivalent to the amount of net worth in the form of share capital, earned surplus and capital surplus on the part of a corporate enterprise. Similarly, long-term borrowings are to be witnessed not only in the case of debentures, but also in mortgaged loans procured from industrial banks and special finance corporations. Strictly

1 Gerstenberg, C. W., *Financial Organization & Management of Business*, p. 72.
2 Husband & Dockeray, *Modern Corporation Finance*, p. 196.

speaking, all forms of funded obligations or long-term debts, whether secured or unsecured, become a part and parcel of the amount of capitalization. In other words, all permanent and semi-permanent funds employed in a business are to be looked upon as the effective amount of its capitalization.

The test of any financial planning, and for that matter, capitalization, lies in the availability of cash in the right amount and at the right time. A steady and timely supply of cash becomes a question of life and death to any concern. The solvency of any business is judged primarily in terms of the availability of cash, not in terms of its profitability. Even against losses, an enterprise can keep itself going for a certain time with the sufficiency of cash ; in contrast, insufficiency of cash may cause the end of an enterprise despite its making profits. The amount of capitalization is tied up with the questions of cash availability for ensuring the steady flow of cash for meeting the needs of a company. As the supply of cash centres round the estimate of short-term funds, or working capital as they are called, the study of this aspect may be deferred for its discussion in the context of working capital. Suffice it to say here that capitalization has an important bearing on the right amount of working capital and its important component, cash.

Theories of Capitalization. For ascertaining the amount of capitalization on the part of a new company, two theories have gained currency, *viz.*, (1) the earnings theory and (2) the cost theory. *The earnings theory* has its roots in the return on investments. Investments are made in a business with the object of making some earnings therefrom in the shape of dividends and interests. And in a competitive market, earnings of the investors must have a close relationship with the rate of return on comparable investments. If other enterprises in the same line of business are giving, say, six per cent rate of return, whether on ownership capital or on borrowed capital, the new enterprise is expected to pay as much rate as others do. To pay this fair rate of return from its probable earnings, the amount of capitalization is figured out from the expected volume of earnings and the prevailing rate of return. For example, if ten per cent be the rate of return and rupees one thousand be the expected earnings of a business, the amount of capitalization would come to rupees ten thousand in terms of the earnings theory. As the earnings theory is based upon two factors—the fair rate of return and the probable future earnings, any miscalculation in respect of these factors would lead to the adoption of a wrong amount of capitalization. For safeguarding against these miscalculations, particularly the amount of future earnings, there are two methods involved in calculating the amount of capitalization. The first is the Analytical Method in which different items of expenses and revenues

are figured out from study, observation and statistical computation for arriving at a correct estimate of probable earnings. In the Comparison Method, a number of concerns in the similar line of business and of the same size are inspected for comparing their operating data and financial statements. However, these two methods are not mutually exclusive ; rather both of them are used in conjunction for obtaining better results.

Under the *cost theory*, the amount of capitalization is determined from the summation of a number of capital expenditures required for putting the company as a going concern. Starting from the promotion of a company to its operation as a going concern, the usual capital expenditures include (*a*) the cost of fixed assets like land, building, plant, machinery, etc., (*b*) the cost of establishing or developing the business to a stage of self-supporting in matters of income and expenditures, (*c*) the irreducible amount of working capital which is necessary to keep the business in running condition, (*d*) the amount of promotion and formation expenses, and (*e*) the cost of financing by way of commissions and brokerages. Although the cost theory appears to provide a realistic connection between the amount of capitalization and the value of the company's assets, it very often proves to be an unsatisfactory basis of capitalization. The value of assets is as good as the use made of them ; if they are not properly employed or they remain idle, the true worth of the business becomes lower than what the amount of capitalization warrants.

The deficiencies of the cost theory can be clearly revealed by considering the amount of capitalization on the part of an existing company. The cost theory utilizes historical cost or book value of assets as the basis of capitalization. But for an existing enterprise, the measurement of the amount of capitalization can be effected by the market value of securities as quoted in the stock market. The present earnings and future prospects of the company are reflected in the market values of securities, and such values are indicative of the true worth of a business. As it happens, wide discrepancies may be found between the worth of the company as shown by book values and by market values. The standard accounting practice makes the book value an unrealistic one for many reasons. First, the stock-in-trade is valued at cost or market price, whichever is lower. Secondly, the fixed assets are shown at original costs minus depreciation. But the real worth of fixed assets is determined by the prevailing price level in the country, by the deduction of a fair rate of depreciation from the value of assets, as well as by their current use and application in the concern. For all these reasons, book value may not be indicative of the correct situation. Thirdly, various types of company reserves magnify the market value because of their influence as a cushion of safety. Finally, many

intangible assets are there to cause a distortion between the book value and the market value of assets of a concern.

Over- and Under-capitalization. As there are two bases of capitalization—earnings and cost, the questions of over-capitalization and under-capitalization may be judged from two different standpoints. As regards earnings, over-capitalization arises in those cases where the company earnings are too low to give a fair return on the shares and debentures issued by the company. This failure to provide a link between the amount of investments in the form of shares and debentures and the amount of earnings made by the company stems from either over-estimating the earnings or underrating the return on investments. Whether earnings are calculated towards higher amounts or the rate is taken at lower levels, the effect is the same; the market value of securities would come down below par, and shares and debentures would be selling at discounts in the stock market. Likewise, under-capitalization exists when the earnings of a company are too high to give a larger rate of return on its securities than the rate enjoyed by comparable investments. The higher rate of return on the investments in a company may be caused by under-estimating the earnings or by overrating the return on such investments. Whatever might be the cause, the market value of securities would go higher than par value or face value and securities would be selling in the market at premiums.

As regards cost or value of assets, over-capitalization appears from the overvaluation of assets in relation to the amount of shares and debentures issued by a company. That is, the amount of securities exceeds the company's assets in value, and the capital is not fully represented by the value of these assets. Such overvaluation of assets may be caused by a number of ways: (*i*) by stock watering through the issue of securities to the company promoters and others without receiving equivalent considerations for such issues, or through the acquisition of tangible or intangible property at inflated prices and making payments therefor by the issue of securities; (*ii*) by charging a lower rate of depreciation; and (*iii*) by acquiring assets during rising price level at prices which have fallen now. In the like manner, under-capitalization appears from undervaluing assets more than what their true value warrants. That is, the amount of securities is too small in comparison with the real worth of the assets. This undervaluation of property may be brought about by receiving a greater amount of assets than the worth of stock given in exchange justifies it, by charging an excessively high rate of depreciation, or by the effect of a subsequently rising price level.

A wrong valuation of assets may not lead to a shortage of capital in the case of under-capitalization or to a redundancy of capital in the case of over-capitalization. Irrespective of the basis of valuation, under-

capitalization may be associated with too little capital because of making an incorrect estimate of capital needs. However, under-capitalization in relation to assets is likely to give rise to a shortage of funds at a later date unless remedial measures are taken in the meantime. Over-capitalization in relation to assets shows a redundancy of capital in business with depleting assets like mining and oil companies. Barring this, over-capitalization does not exist in the sense of superfluous or excess capital accumulation on the part of a company. Futhermore, over-capitalization through an overvaluation of assets does not imply the existence of watered stock in all cases. As we have seen earlier, stock watering is only one of the three ways in which an overvaluation of assets can be effected. Watered stock, as the name implies, represents those security issues which are not covered or backed by the value of company assets. Since the value of assets lies in their effective utilization, not in the stamp given to such assets in the company's books, over-capitalization may not arise from stock watering despite the fact of overvaluation of assets. Through increased earnings by the use of those overvalued assets, the water in stock may be squeezed out entirely.

Evils of Over- and Under-capitalization. Over-capitalization creates a number of problems and invites difficulties for all concerned in its wake. From the side of the company, the evils include (1) the serious fall in credit standing of the company because of its poor earning capacity, (2) the inability to raise additional capital from the market for improvement purposes, (3) the premium on dishonesty and inefficiency on the part of management personnel by allowing them to make window-dressing arrangements and the subordination of company interests to their individual interests, and (4) the exploitation of consumers, workers, suppliers and shareholders by way of denying their legitimate interests. From the standpoint of shareholders, the evils are (*i*) the stoppage of dividend payments, (*ii*) lack of marketability of shares on account of a heavy fall in their prices and consequent risk of capital loss on investments, (*iii*) little value of shares as security for the purpose of obtaining loans against them, and (*iv*) the assumption of financial burden required for the reorganization of the company. The community as a whole is affected by (*a*) the threatened closure of the company, and the resulting unemployment and reduction in the supply of goods and services, (*b*) the uneconomic utilization of scarce resources through the production of bad quality goods at higher costs, (*c*) the consequent wastage of funds in the form of reorganization, and (*d*) the introduction of a vicious atmosphere in the business world and of an element of instability in matters of economic progress.

Under-capitalization, on the other hand, may give rise to financial

difficulties on the part of companies and may lead to business failures requiring reorganization and recapitalization. Because of high earnings, it causes large fluctuations in security prices, and thereby wild speculation in shares is encouraged and fostered. Through increased earnings, under-capitalization creates discontent among workers, and labour disputes gather momentum from such grievances. Consumers feel aggrieved for not giving them any benefit in the shape of reduced prices. And the top-management personnel have to remain busy with financial matters instead of giving attention towards the improvement in basic functions of the business.

In comparison with over-capitalization, under-capitalization is a lesser evil no doubt, but both of them result in financial difficulties which prevent the normal and steady growth of the enterprise. What is implied in sound financing is to strive for a correct amount of capitalization, neither over-capitalization nor under-capitalization. Business failures and reorganization may be caused under both the circumstances, entailing a great loss of funds. (However, a further discussion about business failures and reorganization will be made towards the end of this Chapter).

Remedies for Over- and Under-capitalization. The best remedy for over-capitalization is to increase the earnings of the company for the purpose of removing the water out of the outstanding amount of securities. With the same amount of capitalization, higher earnings can offset all semblances of over-capitalization. Alternatively, when earnings cannot be improved, a reduction in the amount of capitalization is to be effected by scaling down the value of outstanding debentures and shares. A reduction in the rates of fixed return on debentures and preference shares can also be of some help in the situation. But where the matter has gone too far and the extent of over-capitalization is very wide, no measure can save the enterprise from collapse except a thorough reorganization.

Under-capitalization can be remedied by increasing the amount of shares and debentures. This remedy is particularly desirable in those cases where an under-capitalized concern finds a shortage of funds. If reserve positions permit the issue of bonus shares, a stock dividend becomes an easy remedy for under-capitalization. By splitting the face value of each share into shares of smaller denominations, a lesser degree of under-capitalization can be avoided. Sometimes, the book value of assets is written up for capitalizing the amount thus available from the source of capital profits. However, an under-capitalized concern cannot carry on its operation for a prolonged period without remedying the situation. Unless adequate measures are taken beforehand, an under-

capitalized but successful company may have to go out of existence for its shortage of funds, particularly in respect of working capital.

COMPOSITION OF CAPITAL STRUCTURE

The second aspect of capitalization or capital structure involves the selection of securities and the determination of their proportionate amounts. This is known as capital gearing which represents the fixation of a proper ratio between two or more types of securities. Capitalization on the part of a company is highly geared when the proportion of equity capital to total capital is small. Capitalization is low geared when the equity shares predominate in the capital structure. The higher the gear, the more speculative will be the character of equity shares, because after meeting the fixed rate of return on debentures and preference shares, the residue of profits is to be divided among the comparatively small number of equity shareholders.

According to the prospects of earning, the capital structure of companies should be devised with different securities in such a way that it would become safe as well as economical. The general principles that guide the issue of three different types of securities, viz. debentures, preference shares and equity shares, may be stated as follows : (*a*) debentures should be issued by a concern that is expected to have a stable and sufficient income to pay the fixed interest charges ; (*b*) preference shares being normally cumulative in nature can be issued when the average earnings are fairly good, though annual earnings may be of uncertain character ; and (*c*) when there is no certainty of income, equity shares should be issued. But these general principles do not help much in determining the actual proportion of different securities in the capital structure. A company is required to issue all the three types of securities, not a particular one that is suggested by general principles.

Factors of Capital Gearing. The following six factors decide the composition or make-up of the capital structure :

1. *Trading on the equity*—It refers to the additional profit that equity shares earn at the expense of other forms of securities. It represents the arrangement under which an enterprise uses borrowed funds carrying a fixed rate of interest in such a way as to increase the rate of return on the equity shares. By the issue of debentures and preference shares with fixed returns, the dividend rate can be substantially increased for the equity shareholders. Instead, if the entire capital is raised in the form of ordinary shares, the dividend rate cannot be raised to that level which is attainable otherwise. But there are two limitations of this policy of trading on the equity. First, when the earnings are not sufficient to pay the fixed return on the entire investments including the equity shares,

the dividend rate is unduly depressed rather than accelerated. Secondly, the company must have sufficient assets that can be offered as security to the lenders.

(The principle can be easily explained by an illustration. For example, a company is capitalized at Rs. 1,000, out of which the debenture-holders and preference shareholders contribute Rs. 600, and the equity shareholders Rs. 400. If the fixed rate of return is 6% and the total divisible profit is Rs. 100, the ordinary shareholders would get 16% dividend. When the capitalization is further geared up to make the proportion of securities at Rs. 800 to Rs. 200, the dividend rate can be increased for the equity shareholders to a level of 26%. This principle is advantageous so long as the profit exceeds Rs. 60 (the return on Rs. 1,000 @ 6%). If the profit comes down below Rs. 60, the rate of dividend would be unduly depressed ; it is a double-edged sword that cuts both ways).

2. *Control of the enterprise*—The desire for control decides the types of securities that are to be issued by a company. The control of the enterprise is concentrated in the hands of equity shareholders, and the holders of debentures and preference shares usually have no voice in managing the company. Accordingly, the lust for control on the part of promoters or existing management will determine the proportion of securities between equity shares and others.

3. *Elasticity of capital structure*—The capital structure should be made elastic with a view to providing for expansion and raising of further capital. Too much use of debentures and preference shares makes the capital structure rigid due to the requirement of fixed payments. As a general practice, debentures are not issued in the initial stage and they are reserved to be issued in future for the purpose of meeting emergencies and expansion. The use of debentures is served through the issue of preference shares at the commencement.

4. *Likings of investors*—The company is required to issue varied types of securities in order to meet the wishes of the investing public, otherwise sufficient capital may not be accumulated. Depending on their individual preferences, investors purchase different types of securities. The investors who regard the security of principal and stability of income as more important than other factors are likely to purchase debentures. Preference shares are taken up by those investors who want a higher but more certain income along with the safety of capital. Equity shares are purchased by investors who are willing to take risks of the business and to share control of the enterprise in the hope of deriving a higher income as well as some capital appreciation of their investments.

5. *Cost of financing*—The cost of financing exerts an important influence upon the selection of securities, since the funds are collected at

varying costs through the medium of different types of securities. However desirable it may be to secure funds through a particular security, the cost factor often prevents the use of such security in the capital structure. To facilitate the raising of capital, denominations of different securities can be suitably adjusted to reduce the cost of financing.

6. *Conditions of the capital market*—The conditions of the capital market and prejudices of the investors may determine the form of securities in the capital structure. Debentures are marketed more easily in times of depression than equity shares which find a better market during rising prices. Again, institutional investors are often prevented from purchasing the equity shares, and they restrict their transactions in trustee securities that include debentures and some preference shares only. Consequently, the time of issue and the composition of buyers in the market may influence the selection of securities by a company.

ESTIMATING TOTAL CAPITAL REQUIREMENTS

Long-term capital requirements for the starting of a company's business may be analysed under the following five heads :

1. *Promotion and formation expenses*—For the promotion of companies, there are investigation and assembling expenses involved in securing necessary legal, engineering and other technical advice. In getting the company incorporated and started, there are registration fees, drafting and printing expenses of several documents and statements, as well as office expenses and staff salaries up to the commencement of business. All these expenses are usually lumped together under the title of "preliminary expenses".

2. *Cost of fixed assets*—For acquiring fixed assets like land and building, machinery and equipments, and furniture and fixtures, a large amount of capital investments is needed at the beginning.

3. *Cost of establishing or developing the business*—To develop the business to a stage of self-supporting or profitability, some time must be allowed to any concern. The outgo exceeds the income during this development period, and provision is to be made for the inclusion of such operating losses in the estimate of capital requirements. The development period, or "gestation period" as it is alternatively called, becomes proportionate to the degree of mechanization and specialization adopted in a company. The greater the period, the higher will be the cost of establishing the business.

4. *Regular working capital*—Working capital is necessary for running the business. For enabling a new company to run its affairs, a certain amount of capital is to be kept reserved for working capital purposes. As explained in the following pages, it will be found that working capital consists of two parts ; one part is known as regular,

fixed or initial working capital and the other part is called variable or seasonal working capital. In nature and significance, regular working capital has no difference from the cost of fixed assets, i.e. fixed capital.

5. *Cost of financing*—For procuring capital in the form of shares, debentures, mortgaged loans or other long-term deposits, there are certain costs involved in financing the business. For canvassing, advertising, brokerage and commission payments or for making mortgage deeds, the cost of financing becomes a significant one. For purposes of security listing on a recognized stock exchange, at least 49 per cent of the issued capital is to be offered to the public for subscription under Rule 19(2) (b) of the Securities Contracts (Regulation) Rules, 1957. Because of this requirement, the cost of financing is to be reckoned as an important part of capital needs of all public limited companies.

Fixed Capital. The term "fixed capital" is commonly used in two different senses. In one sense, the amount which is necessary for acquiring fixed assets by any concerns is taken to be its fixed capital. Briefly, the cost of fixed assets is referred to as fixed capital. But fixed capital is also taken in the sense of all long-term investments in the business. In our analysis of capital requirements, we have seen that long-term investments are necessary for five different purposes, of which cost of fixed assets is only one. Strictly speaking, the amount of capitalization is concerned with all types of long-term financing and makes adequate provisions for all of them. Whenever the concept of long-term funds is confined to the cost of fixed assets alone, the company is bound to be under-capitalized seriously and threatened with the constant fear of going out of the business.

Despite other requirements, the cost of fixed assets becomes the dominant part in the amount of capitalization. However, the cost of fixed assets varies from concern to concern depending upon the nature of business activities, the type of manufacturing, the size of business, as well as the mode of acquiring the fixed assets. As regards the nature of business activities, marketing enterprises require a small amount of fixed capital as compared with the industrial concerns in general. Again, public utility concerns and producers' goods industries require a much greater amount of fixed capital than what is necessary for consumers' goods industries. Enterprises like railways, tramways, or electricity companies have to be started at their full stature in the very beginning, and hence the cost of fixed assets becomes comparatively large. On the other hand, most of the consumers' goods industries can be started on a modest scale and expanded gradually for reaching their full growth. As to the type of manufacturing, the conditioning or converting industries require a much smaller amount of fixed capital than what is required

in analytical processing or in synthetical processing industries. The size of business is an obvious determinant of the amount of fixed capital.

As regards the mode of acquiring fixed assets, they can be purchased outright or on the basis of instalment payment. Particularly valuable machineries can be acquired on such instalment system. Some other assets like land and buildings are acquired in many cases on the basis of lease agreements. Moreover, in many concerns tools and equipments are manufactured by the companies themselves for meeting their own requirements. These different considerations affect the amount of fixed capital.

Working Capital. Working capital is necessary for holding some convertible assets like stock of materials and finished goods, bills receivable, accounts receivable and cash. Through the use of these assets, the operation or working of the business is carried on. These assets rotate around the business activities in a circular way and are fed back again and again in the circular flow. There is a definite cycle about the movement of these assets. As for example, materials are processed or transformed into finished goods which are sold on credit for creating bills receivable or accounts receivable, and such bills or accounts receivable are liquidated into cash that can again be utilized in purchasing materials for production purposes. But working capital does not represent the amount invested in these assets. The group name of these assets is "current assets".

Corresponding to these current assets, there is a group of current liabilities comprising bills payable, accounts payable, expenses payable, etc. Working capital is the excess of current assets over current liabilities. The amount required for financing the current assets must not be confused with working capital. Furthermore, the entire amount of working capital does not involve short-term funds. As already pointed out, working capital consists of two parts—regular and variable. Regular working capital partakes of the character of long-term funds and remains permanently sunk in any going concern for holding certain minimum quantity of raw materials, finished goods or cash. Beyond this amount of working capital, there is the variable part of working capital which involves the use of short-term funds. Regular working capital must be financed from the sources of long-term funds, and variable working capital may be obtained from other sources. That working capital is not increased by some types of short-term borrowing can be explained by one illustration. When an outright cash loan of Rs. 10,000 is obtained from a commercial bank, current assets are inflated by that amount in the form of either cash or other items. But current liabilities also go up to the same amount of Rs. 10,000 in the form of bank loans. Working capital being defined as the excess of current assets over current liabi-

lities, no improvement in the amount of working capital takes place from this bank loan. But such loans inflate the amount of current assets and may be repaid after the conversion of some current assets into cash.

Importance of adequate working capital—Adequate working capital is one of the prerequisites for the continued success and smooth operation of the business. Business performance is bound to come down, and even to a halt, in the absence of adequate working capital, no matter how much the concern has invested in fixed assets. In the first place, sufficient funds are necessary for purchasing materials and meeting the day-to-day expenditures in the form of salaries, wages, rent, rates, etc. As these payments cannot be deferred without having a serious consequence upon the business, there must be prior provisions for such funds. Secondly, payment to sundry creditors is to be done timely for the maintenance of reputation and credit standing of any company. Moreover, prompt payment results in the benefit of cash discounts. Thirdly, advances from banks are conditioned by the availability of sufficient liquid assets. Fourthly, for the payment of cash dividend to shareholders, funds are necessary ; but if such funds are not available and dividend distribution is deferred, further capital cannot be secured by the company from the investing public. All these considerations explain the importance of sufficient liquid funds.

However, any greater working capital than what is required for the needs of the business is also not desirable. If funds remain idle in a concern, the return on investments is likely to be poor. Besides, unnecessary funds encourage speculation and contribute towards inefficiency and irresponsibility on the part of management personnel. Adequate working capital is vital for the efficient functioning of a business ; and to provide for a margin of safety, the amount may be exceeded up to a definite limit. But beyond all such reasonable requirements, any excess accumulation of working capital proves to be an indication of the company's weakness.

Amount of Working Capital. The amount of working capital cannot be stated in absolute terms without any reference to the amounts of current assets and current liabilities. Being the excess of current assets over current liabilities, working capital must bear a definite proportion between them. The rate of rapidity with which current assets are converted into cash and the relative size of both current assets and current liabilities are important considerations in determining the amount of working capital. There is more or less a given proportion of current assets to current liabilities in the case of all enterprises engaged in a particular line of business, and that proportion cannot be violated without inviting troubles and financial difficulties.

The following are the general factors which regulate the amount of working capital :

1. *Particulars of raw materials*—(*a*) quantity and value of materials to be held in store, (*b*) need for stockpiling, (*c*) terms of purchasing, and (*d*) rapidity of the use of materials in production (raw materials turnover).

2. *Character of manufacturing*—(*a*) seasonal, intermittent or continuous production, (*b*) time consumed in manufacturing, and (*c*) the amount of wages and other manufacturing expenses.

3. *Particulars of finished goods*—(*a*) quantity and value of stock-in-trade, (*b*) rapidity or frequency of sales from stock (finished goods turnover), (*c*) terms of sales, and (*d*) time consumed in effecting delivery.

4. *Amounts receivables*—(*a*) size of amounts receivables by way of bills or open accounts, (*b*) relative position of amounts receivables with amounts payable, (*c*) average collection period (turnover of accounts receivable), and facility of discounting bills and effectiveness of collection efforts.

5. *Liquid cash*—(*a*) existence of emergencies like strikes, fires and other calamities, (*b*) operating expenses for salaries, rents, rates, taxes, transport charges, etc., (*c*) pressing obligations of trade and other creditors, and (*d*) facility of fall-back reserves on bank credit and available temporary investments in securities.

Main Determinants of Working Capital. The factors which affect the amount of working capital centre round the volume, value and velocity of both production and sale. The test or measure of the effective utilization of working capital lies in computing the working capital turnover. This turnover is obtained by dividing net sales (gross sales less returns) by the amount of working capital. If turnover rates are comparatively high, they are a pointer to the efficiency of management personnel ; on the other hand, comparatively low rates are indicative of poor performance on the part of a company. But too high or too low turnover rates are danger signals. Too high rates represent a case of serious under-capitalization, while too low rates mean serious over-capitalization.

Production and sale are the two basic functions of business enterprises and all other functions are adjusted to the needs of manufacturing and marketing. Accordingly, the volume of production and sale casts a significant influence on the patterns of business activities and on the amount of working capital. To maintain a certain volume of production, whether carried on intermittently or regularly, materials are to be purchased. Materials can be purchased on cash or credit terms, from the local or the foreign market, as well as in varying quantities through spe-

culative deals or hand-to-mouth buying. Sometimes, stockpiling of materials has to be effected for the impending rise in the price of materials, for the seasonal supply of materials or for the expected short-supply of materials. As a result, amounts tied up in materials are dependent upon a number of considerations. Secondly, the volume of production or sale in itself does not provide any guide to the amount of working capital. The value of units is widely different in different cases. For example, one tonne of coal does not mean the same value with one tonne of steel or cement. It is the volume of products multiplied by their value that gives a fair indication of working capital needs. Thirdly, the velocity or rapidity with which production and sale are carried on becomes an important determinant of working capital. Slow-moving production or sale is much costlier than fast-moving goods, and hence working capital requirements vary with the rate of their movements. Sales are made for realizing certain money benefits from the buyers, and the sooner the receipt of such benefits, the lesser would be the requirements of working capital. To put in brief, the volume, value and velocity of production and sales go to the heart of working-capital needs.

Relative Amounts of Fixed and Working Capital. For each kind of business, there is a relative proportion of fixed capital to working capital, and this proportion cannot be disturbed without causing serious imbalance in the capital structure. The proportion of capital varies with the nature of activities. For example, public utility concerns including transportation companies require a smaller amount of working capital than what they require in the form of fixed capital. Because of the regularity and quick receipt of income, working capital needs come down sharply in these cases. In contrast, financial and marketing enterprises invest the bulk of their total funds in current assets, and working capital is too high in comparison with their fixed capital. Coming to manufacturing industries, producers' goods industries have a large amount of fixed capital in relation to their working capital, while consumers' goods industries display an opposite tendency. As the process of production becomes more roundabout and extensive, the proportion of fixed capital to working capital goes up substantially. In industries like iron and steel, engineering, petroleum refining, plate-glass manufacturing, chemicals or cement, fixed capital occupies a dominant part of the total capital requirements. On the other hand, working capital absorbs a greater part of the total capital needs in the case of many other industries like cotton, sugar, jute, flour milling, etc.

COMPANY FAILURES, REORGANIZATION AND LIQUIDATIONS

The working of an enterprise, whether successful or unsuccessful, is reflected in the capital structure of the company. That is to say, the net results of business operations are mirrored into the amount as well as

the composition of capitalization. As human beings cannot survive without eating, so no business enterprise can exist without earning profits over several years or without having any reasonable prospects of profit earnings. The profitability of the business being removed, the companies have to abandon the existing business. Such abandonment is referred to as "business failures." Business failures on the part of a company may be either partial or total depending upon the degree of such failures. If the situation goes beyond the scope of any readjustment or revival, business concerns have to close down their affairs because of total failures. In contrast, where there are chances of reviving the business through the introduction of some changes in their affairs, business enterprises are restarted after meeting the requirement of partial failures. Briefly, liquidations are the inevitable result of total failures, whereas reorganization and reconstruction take place in the case of partial failures. The extent of company failures is very wide in our country. More than fifty per cent of the companies that were registered up to the pre-independence period have had to liquidate their affairs. Even in recent years, company failures have not been reduced in the least degree. During the six-year period from 1950-51 to 1955-56, the number of new company registrations was 9142, while 6043 companies with a paid-up capital of Rs. 57.1 crores went out of existence in the same period. During the sixteen-year period from 1956-57 to 1971-72, against 22,242 new registrations 19,047 companies have ceased to work or liquidated ; this large number of liquidations arises from the vigorous policy to strike off the registers moribund or defunct companies.

Causes of Company Failures. The causes of failures are generally classified under two heads : internal causes and external causes. Management is entirely responsible for internal causes and is also partly responsible for external causes, since some of them can be prevented by reasonable planning and forecast.

EXTERNAL CAUSES : *Business cycle*—During periods of depression, many concerns are weeded out from the field of business. Businessmen cannot adjust themselves in between swings of the business cycle. In periods of prosperity, business is often overexpanded with a buoyant optimism, and this overexpansion leads to a large number of failures in the ensuing depression. Businessmen are caught unprepared by the vagaries of trade cycles, and enterprises do not survive the shock. This situation specially arises from the deficiency of our knowledge about the exact height as well as depth of peaks and valleys of the business cycle.

b. Intense competition—Competitive struggle results in the elimination of those enterprises which are weak in resources and size.

Because of several economies of large-scale operations, the cost of production becomes lower in the case of large producers, and they appear as a perpetual menace to small business concerns. Moreover, fighting brands of products are frequently introduced by monopolistic producers to strike a death blow to other producers in the line for the purpose of extending the market further. Consequently, many enterprises fall victims to this intense and unfair competition.

c. Changes in productive and distributive methods—A business enterprise may be required to quit the field of business because of its inability to adjust itself with the changing conditions of time. Business changes are so rapid and thorough nowadays that many concerns cannot cope with the circumstances.

d. Changes in demand—New products or services are continually being developed by research and innovations. The demand for old products is generally replaced by the new type of demand whenever a significant improvement is made in the design and usefulness of goods. For example, many natural products have been ousted from the market by a better type of synthetic products. Changes in demand may also arise from several other factors. Whatever may be the reason for it, business enterprises dig their own graves by their inability to switch over to the production of those new goods which have a demand in the market.

e. Natural disasters—Natural disasters like earthquakes, fires, floods and crop failures may cause ruin to the concern. Although these risks can be covered by insurance policies, they do not usually give adequate protection to business enterprises, particularly when the market is affected by these disasters. Business enterprises are faced with a similar situation by the destructive effects of war.

INTERNAL CAUSES : *Managerial incompetence*—All internal causes stem from managerial incompetence, since management is the most vital force in business charged with planning and directing all activities. The failure of management is clearly evidenced in a concern which cannot supply desired goods or services at a satisfactory price. Management cannot absolve itself from blame when the primary function of the business is not discharged.

2. *Defective promotion*—It has been found from experience that many business concerns have to close their doors because of defective promotion. The discovery of business opportunity might not have been done on a sound basis. As a result, the demand for the product was incorrectly overestimated or the cost of production was underestimated at the time of initial promotion. In such a situation, the business enterprise cannot succeed in spite of its best efforts.

3. *Poor financial planning*—Poor financial planning results in over-capitalization or under-capitalization of the concern. Once the business enterprise is confronted with these problems, there is no way

out but to reorganize or to liquidate its affairs. It has been discussed elsewhere that an over-capitalized concern is placed in a death-trap from which it can be saved by heroic efforts only.

4. *Unwise dividend policy*—Expansion is the normal rule in all businesses. A business enterprise cannot successfully work by refusing to supply the desired volume of products in the market. Whether it likes it or not, expansion is to be carried on with the growth of consumers' demand. In order to support this increased volume of production and sale, sufficient capital must be available. The major part of this additional capital is universally obtained from retained profit. If the dividend policy does not help in the creation of necessary reserves, the enterprise is likely to be placed in serious difficulties. Further, reserves are necessary to pay a stable rate of dividend and to provide against unforeseen contingencies and hazards.

5. *Lack of records*—Accounting and statistical records provide the necessary guides and danger-signals to the business enterprise. Absence of these records means a type of working which is characterised by uncertainty and guesswork. The business may be forced out of existence at any time.

6. *Dishonesty and fraud*—Dishonesty and fraud on the part of employees result in business failures. When trusted employees and top executives milk the enterprise and drain off its funds by dishonest and unfair means, the business is doomed to fail.

7. *Death or sickness*—When the entire control of a business enterprise is centralized in one person, death or sickness of that person tends to terminate the existence of the business. This usually happens in a proprietary concern. This situation may also arise in the case of those companies which have failed to set up a proper organization structure with requisite delegation of authority. Death of the managing director in a concern may create such a vacuum that the enterprise is thrown out of gear and liquidated.

Reorganization. In case of partial failures, reorganization and reconstruction are carried out by adjusting the capital structure, indebtedness, productive method, management pattern and other like phases which have caused the business failure. The Companies Act, 1956 has made the definition of the term "reorganization" very wide by the inclusion of any arrangement or compromise between members of the company for the alteration in its share capital, amalgamation with other concerns, or reconstruction under a new form. Strictly speaking, reorganization implies the emergence of a new company to replace an existing company, the identity of which is not traceable even in the name of the new company. But reconstruction means the rebuilding of the enterprise under a new name that uses at least a part of the old

company's name for securing the benefits of established goodwill available on the part of the defunct company. As pointed out by Hoagland, "while reorganization undertakes to replace one corporation by another, reconstruction attempts to make repairs by whatever method seems most suitable." In this sense, reorganization is carried out by amalgamation or by merger. For purposes of amalgamation, a new company is formed to take over the business of two or more companies that are wound up or liquidated. In mergers, on the other hand, an existing company buys over the business of the company in dissolution. In contrast, reconstruction is understood in the sense of internal arrangements on the part of members or creditors of the company for reviving the business without taking any resort to consolidation, whether in the form of amalgamation or merger.

However, the Companies Act provides for different types of reorganization. *First,* reorganization can be effected by altering the share capital clause of the Memorandum through the consolidation of shares of different classes or through the division of shares into shares of different classes. *Secondly,* where the majority of creditors or members, representing three-fourths in regard to their respective interests, agree to any compromise or arrangement, such reorganization would be binding on all creditors or members with the sanction of the Court. The Court may supervise the carrying out of reorganization for the protection of creditorship or membership interests and may cause the repayment of interests to the dissenting parties. This reorganization can be effected by the winding up of the company or without effecting any such winding up. *Thirdly,* the Central Government may order for the amalgamation of two or more companies into one concern in the public interest.

Liquidations. Liquidations are resorted to in the case of total failures arising from insolvency of the company, illegality of the business, unprofitable prospects of the enterprise, or any other compelling reasons. Being a body corporate, companies can be dissolved by different methods of winding up prescribed in the Companies Act, 1956. This winding up of the company's business may be necessary for the purpose of reorganization and for liquidation or termination of the business itself. In the case of reorganization, old business activities are continued under a different arrangement, but liquidation in contrast to reorganization implies a total abandonment of the business. Accordingly, the owners of the company are at liberty to retain their investments under the scheme of reorganization, while they are to take a refund of capital investments in the case of liquidations provided funds are available for the purpose.

The Companies Act, 1956 provides that companies can be wound

up by three different methods : (*a*) compulsory winding up by the court, (*b*) voluntary winding up by members or by creditors of the company, and (*c*) the winding up under the supervision of the court.

Compulsory winding up—A company is liable to be wound up by the court in circumstances like (*i*) decision of the company in general meeting arrived at by a special resolution for going through such winding up, (*ii*) default in delivering the statutory report to the Registrar or in holding the statutory meeting, (*iii*) delaying commencement of business beyond one year from the date of incorporation or suspension of the business for a complete year, (*iv*) reduction in the number of members below two in the case of private limited companies and below seven in public limited companies, (*v*) inability of the company to pay its debts, and (*vi*) the discretion of the court on a just and equitable ground. For effecting this winding up on the initiative of the company, whether through its members or creditors or on the initiative of the Registrar of Companies, a petition is to be made to the court ; the court after hearing the objections of interested parties passes a suitable order. When an order for winding up is made by the court, an official liquidator is appointed with definite powers and duties to go through the liquidation affairs.

Voluntary winding up—Members' voluntary winding up may be decided by a resolution in general meeting according to the terms contained in the Articles or by a special resolution to that effect. In the case of members' winding up, a declaration of solvency is a prerequisite condition. Creditors' voluntary winding up can be initiated by calling a creditors' meeting for the purpose and by passing resolutions in that meeting. In both the cases, liquidators are appointed by the parties to look after their interests and to execute their decisions with an arrangement for reporting to them from time to time.

Winding up under court supervision—Voluntary winding up may be placed under the supervision of the court at any time, and for this, the court makes a decree on proceedings brought by any affected party. Voluntary winding up may be conditioned by such restrictions as may be necessary for the protection of various interests and for the administration of justice. Furthermore, the unofficial liquidators may be removed from their offices, and new liquidators appointed in their places.

CHAPTER 17

FINANCIAL MARKETS AND RAISING OF CAPITAL

SOURCES OF CAPITAL

The term "source" implies the agencies from which capital is procured in the business world. For two types of capital, *viz.* fixed and working, different sources are tapped by business enterprises. Fixed capital involving long-term financing is primarily available from two sources—buyers of securities and lenders of long-term funds. Working capital, on the other hand, involving partly long-term financing and partly short-term financing, can be procured from the suppliers of fixed capital as well as from the lenders of short-term funds. That is to say, the sale of securities and the borrowings of one kind or another are the principal means of securing capital on the part of business concerns. Before proceeding further, it would be appropriate to enquire about the buyers of securities. The following are the important buyers of securities :

1. Investing institutions—(*a*) commercial banks, (*b*) investment trusts, (*c*) industrial banks, and (*d*) finance and development corporations.
2. Institutional investors—(*a*) insurance companies, (*b*) religious and charitable institutions, and (*c*) building societies.
3. Provident funds societies.
4. Individuals—(*a*) investors and (*b*) speculators.
5. Limited liability companies.

As in the case of buyers of securities, the lenders of funds include a number of agencies, *viz.* commercial banks, finance and development corporations, individuals, companies, and business houses (trade credit). In addition, the State comes to the rescue of some business enterprises by giving direct loans to them.

Long-term capital, whether in the form of securities or borrowings, is raised from the capital market, while short-term capital is procured from the money market. For raising short-term capital from the constituents of the money market, different credit instruments are used. These credit instruments are concerned with *Methods of Financing* as opposed to the sources of short-term financing. (Methods of financing have been discussed separately in Chapter 19). As regards sources, capital is accumulated from the constituent members of the money market and the capital market. The capital and money markets are integral parts of one

composite financial market. Before going into the discussion on specific sources of fixed capital as well as of working capital, an enquiry about the components of the financial market is prerequisite and vital for a clarity of understanding. Accordingly, the discussion of raising capital is preceded by a brief study of the financial market.

THE FINANCIAL MARKET

The financial market refers to the collective name given to the various markets that provide loanable funds to business enterprises and public authorities. It is composed of two major groups : the first group comprises the money market and the discount market which are intimately and inseparably linked together ; the second group consists of the capital market and the securities market which are also closely interconnected. Besides these two groups of markets, there is the foreign exchange market which deals in foreign currencies. (1) *Discount market*—The business of the discount market involves dealings in bills of exchange and supply of funds to different discount houses and bill brokers for their discounting of bills. For the supply of funds, members of the discount market often depend upon the money market, and as a result, the activities of the members of these two markets overlap to a considerable extent. (2) *Money market*—The essential feature of the money market lies in the supply of short-term funds to business enterprises and to the members of the discount market. The chief source of these funds is the commercial banks which are assisted by other agencies and supported by the Central Bank of the country. When the commercial banks wish to increase their cash balances, the Reserve Bank of India enters the money market as a lender of the last resort. (3) *Capital market*—In contrast to the money market, the capital market is concerned with the supply of long-term funds. The term of financing usually varies from a year to the provision of permanent capital in business through the purchase of shares and debentures. Loans of different lengths of time are given by a large number of agencies including the special finance corporations. (4) *Securities market*—It is simply a market for the transfer of ownership of existing securities, and not a source for supply of new capital. Accordingly, the stock market should not be regarded as an integral part of the capital market. But the stock market is an important adjunct to the capital market, because it provides a high degree of liquidity to industrial securities which they would not otherwise possess.

Bill Market in India. The raising of funds through the discounting of bills is highly popular in industrially advanced countries. Besides the commercial banks, commercial paper houses and discount houses are

engaged in the discounting of bills. But in our country, there are no such organized agencies for undertaking this business. The commercial banks were so long reluctant to discount bills because of the absence of rediscounting facility. Since the introduction of bill market scheme by the Reserve Bank of India in 1952, the discounting operations have acquired some importance with the commercial banks of our country.

The commercial banks are accustomed to giving loans in the form of cash credits, overdrafts, etc. But the supply of funds through the discounting operations is much more advantageous to both the borrowing concerns and the commercial banks. The advantages of discounting operations to the borrowers may be summed up as follows : (*i*) The credit facility can be enjoyed for a fixed period and the bank cannot withdraw its credit at any time as in the case of cash credit. (*ii*) The entire present value of the bill is advanced to the borrowers without keeping any margin that is demanded from collateral securities in other forms of bank credit. (*iii*) The assets of the borrowing concern are not hypothecated or pledged and they are available for further borrowings. (*iv*) The cost of borrowing becomes cheaper as compared to other forms of bank credit. (*v*) The amount of borrowing can be suitably adjusted to the requirements of business at different periods.

Advantages to the bank are to be found in the following : (*a*) banks can rely on the security of bills as they are two-named papers, and they can avoid the trouble of taking merchandise as security ; (*b*) self-liquidating character of the bill ensures that the amount will be repaid at maturity and the banks are not to face the embarrassment over renewal of loans ; (*c*) the discounted bills can be utilized for securing emergency funds on the part of bankers ; and (*d*) the banks can select bills having different maturities so as to maintain their twin criteria of liquidity and profitability in regard to their investments.

But despite so many advantages, discounting of bills was not the usual method of obtaining bank credit for certain reasons : (1) limited supply of trade bills because of the predominance of agricultural marketing rather than industrial marketing which alone can ensure a steady supply of trade bills ; (2) absence of rediscounting facility with the Reserve Bank before 1952 ; (3) preference for the cash credit arrangements which are capable of being tailored to the needs of both parties ; and (4) the existence of a high stamp duty.

With the object of imparting a greater liquidity and flexibility to the Indian money market, the Reserve Bank of India introduced in January 1952 a limited bill market scheme. Under the scheme, funds were supplied to scheduled banks against the security of their promissory notes duly supported by discounted bills maturing within 90 days. It did not amount to rediscounting of trade bills by the Reserve Bank, but it constituted one form of lending in the last resort. Although the

scheme provided for advances, not for rediscounting facilities, it enabled the banks to minimise their interest charges by restricting the amount of borrowings strictly to their needs. In November 1970, a new Bills Rediscounting Scheme has been introduced for generating genuine bills in the money market and for evening out the liquidity within the banking system. At the end of June 1973, 38 scheduled commercial banks participated in the Scheme and the total amount of limits sanctioned to them stood at Rs. 183.5 crores.

The Indian Money Market. The money market, in the narrow sense, is concerned with the investment of short-term funds in business enterprises. The Indian money market is composed of the following members : (1) The Reserve Bank of India, (2) The State Bank, (3) Indian commercial banks, (4) foreign commercial banks or exchange banks, (5) the investing public making direct deposits with business enterprises (public deposits), (6) shroffs and other money-lenders, and (7) co-operative banks.

Reserve Bank—As the Central Bank of the country, it acts as a controller of credit and currency with a view to maintaining the internal and external value of rupee, and thereby securing monetary stability in India. It is not concerned directly with the primary function of the money market, but it enters the market through its member banks when they require funds to tide over a crisis. The commercial banks obtain financial accommodation from the Reserve Bank (*a*) against Government securities (*b*) against the discounted bills under the bill market scheme, or (*c*) through the rediscount of treasury bills. Treasury bills are the instruments of short-term Government borrowings. Because the Government receives the greater part of its revenue from taxation in the fourth quarter of the financial year, some amount of borrowings through treasury bills become necessary to cover public expenditure during the earlier part of the year.

State Bank—The State Bank has been entrusted with the task of providing rural finance in addition to its usual function as a commercial bank. It provides business enterprises with their normal requirements of short-term credit as the old Imperial Bank used to do. Through the establishment of 2,867 branches on its part and another 1,563 branches on the part of its subsidiaries up to June 1973, it is expected to provide an enlarged rural credit by way of vastly extending its remittance and credit facilities to both co-operative and commercial banks for meeting all agricultural requirements. The State Bank of India Act has been amended to remove its two limitations regarding the grant of term loan to industries and the sanction of loan against the security of immovable property. The State Bank is now permitted to give loans for varying lengths of time up to a maximum period of 10 years as

compared to the old maximum period of 6 months. Moreover, it is authorised to finance hire-purchase business on the security of book debts.

Commercial banks—Commercial banks comprise scheduled banks and non-scheduled banks. At the end of December 1970, the total number of scheduled and non-scheduled banks was 73 and 13 respectively with 11,184 offices. The total number of offices increased to 15,362 by the end of June 1973. The functions of the commercial banks are summarised as follows : (1) Receipt of money for safe custody on current, deposit, recurring and savings accounts. (2) Transfer of funds from place to place through the dealing in commercial papers and through the issue of bank drafts, letters of credit or telegraphic orders. (3) Supply of funds to customers by granting different types of advances, by discounting bills, or by accepting bills on behalf of customers. (4) Provision of miscellaneous services like handling of securities transactions, arrangement of safe-deposit vault, giving of credit information and acting as agents for certain regular and fixed payments or receipts.

Deposit Insurance Corporation. In the sphere of commercial banking, the establishment of the Deposit Insurance Corporation with effect from January 1, 1962 is a step forward for safeguarding the legitimate interests of small depositors. The Desposit Insurance Corporation invites all the eligible banks including the State Bank of India with its eight subsidiaries for registration as insured institutions. The total number of insured banks declined from 287 in January 1962 to 81 at the end of June 1973 as a result of voluntary amalgamations. The insured banks are required to pay premium of 4 paise per hundred rupees per annum on their deposits with effect from October 1971. The limit of insurance cover per depositor was raised from the initial sum of Rs. 1,500 to Rs. 5,000 in January 1968 and it has been further raised to Rs. 10,000 with effect from April 1, 1970. At the end of September 1972, the insurance scheme covered 96.3 per cent of the deposit accounts and 59.9 per cent of the deposit amounts in the insured banks. Up to the end of June 1973, 404 co-operative banks participated in the insurance scheme. The share capital of the Deposit Insurance Corporation was increased from Rs. 1 crore to Rs. 1.5 crores with effect from January 1, 1972.

Foreign Exchange banks—The foreign banks are branches of well-established banks in other countries of the world with enormous funds at their command. While they are chiefly engaged in financing the foreign trade of the country, some of them have extended their activities to business operations within the country. Out of several foreign exchange banks functioning at present in the country, a few banks have

refrained from taking such deposits. Corresponding to the amount of deposits taken by the foreign banks, some of them have also succeeded in finding an investment outlet in India.

Public deposits—In the twenties and thirties of this century, public deposits were a very important source for the supply of short-term funds to cotton textile mills in Bombay and Ahmedabad centres. Its importance has gradually declined and a greater reliance has been placed nowadays upon other sources. These deposits partake of the nature of fixed deposits and are repayable after a short notice. Instead of making deposits with a banking concern, these deposits are made directly with a mill concern. Consequently, the commercial banks are deprived of these deposits.

Indigenous bankers—They still play a very important part in the Indian money market, and a substantial portion of banking business is carried on by them. Their activities are mostly confined to the commercial and trading business organized on a small scale. They constitute the unorganized sector of the money market. The attempt of the Reserve Bank to bring them under control has failed on the ground that they are not willing to give up their non-banking business which appears more lucrative to them. In December 1963, however, the Reserve Bank has been vested with powers under the Banking Laws (Miscellaneous Provisions) Act of 1963 to regulate the activities of all institutions which accept deposits from the public. Accordingly, the Reserve Bank of India issued directives in October 1966 to the non-banking financial and non-financial companies specifying the period and amount of deposits which they can accept from the public. With effect from January 1, 1973, non-banking, non-financial and financial companies other than hire purchase companies have been permitted to accept deposits for a minimum period of 6 months instead of 12 months stipulated earlier.

Co-operative banks—They are being organized with a new social outlook for giving increased financial assistance to small-scale enterprises and for orderly marketing of agricultural commodities. They are likely to play a more important part in the suppy of short-term funds than they have hitherto done, since vigorous steps have been taken by the Government to develop the co-operative functioning in the country.

CAPITAL MARKET OF INDIA

The capital market is concerned with the supply of long-term funds to business enterprises and to public authorities. The savings of the community are mobilized by different agencies so as to make them available for business purposes. Accordingly, the capital market consists of the

savers and investors, whether individual or institutional. Basically, the savings come from individual persons and corporate enterprises. The business of investing long-term funds is made by a large number of agencies, such as investment trusts, investment companies, commercial banks, provident funds societies, religious trusts, industrial banks, insurance companies and half a dozen finance and development corporations. Being somewhat different in activities, the stock exchange is an important appendage to this market. Besides the above constituents which form the organized sector of the capital market, there is an unorganized sector of the capital market in India. The indigenous bankers in towns and money-lenders in rural areas are completely cut off from the organized sector, and among themselves, they are isolated from one another. They mostly finance for consumption purposes rather than for productive activities and usually charge exorbitant rates of interest.

Growth of Indian Capital Market. Before 1956, the capital market in India had all the characteristics of an underdeveloped economy. There were no institutions and agencies for mobilizing savings and making industrial investments. The capital market was conspicuous by the absence of institutions like professional promoters, issue houses, underwriting agencies and financial intermediaries. This impeded the flow of savings to industries.

The capital market of India has grown substantially in quantitative and qualitative terms in recent years. The following developments are responsible for the rapid growth of capital market in India :

1. *Legislative framework*—An elaborate legislative framework has been built for protecting investors' interests and creating confidence in them. These legislative measures include the Companies Act, the Securities Contracts (Regulation) Act, the Capital Issues (Control) Act, the Industries (Development & Regulation) Act, and the Monopolies and Restrictive Trade Practices Act.

2. *Underwriting agencies*—After the pioneering lead taken by the ICICI in 1956, the underwriting agencies now include LIC, UTI, IDBI, IFC, commercial banks and stock brokers. The extent of underwriting has reached 100 per cent in the case of debentures and more than 90 per cent in the case of shares offered for public subscription from 1965 onwards.

3. *Attitude of commercial banks*—Revising their conservative operations of short-term lending only, the commercial banks have participated in the capital market in several ways. At present they discharge the functions of capital market by way of term lending, subscriptions to the share capital of finance corporations and adopting underwriting operations.

4. *Finance Corporations*—A network of special finance and

development corporations have been established in the country to supplement and strengthen the existing capital market. IFC, ICICI, SFCs, IDBI and IRCI are providing long and medium-term funds to industries through the composite functions of issue houses, underwriting and term lending.

5. *LIC and UTI*—The Life Insurance Corporation and the Unit Trust of India have made a great impact on the capital market by their mobilization of savings for industrial investment purposes on a large scale. In addition to their direct investments in shares and debentures of industrial companies, they have come out lately as the topmost underwriters in India.

6. *Promotional institutions*—The National Industrial Development Corporation and the State Industrial Development Corporations are out and out promotional institutions which are engaged in the floatation of new enterprises and development of industries. Besides other assignments, the Industrial Development Bank of India is also entrusted with the task of promoting giant and crucial enterprises.

7. *Integration of markets*—Through the continuous endeavour of the Reserve Bank of India, an integration between the organized and unorganized sectors of the capital market as well as between money market and capital market has been secured in the country. This consolidation and cohesion of different financial markets has resulted in their co-ordinated and improved functioning.

Investment Trusts. The investment trust is an institution which collects funds from numerous small investors with the object of investing the amount in such a way as to secure a greater diversification of investments and a more certain return on such investment. The safety of capital funds and the certainty of return are two basic objectives of investment trusts. As individual investments are replaced by collective investments of trusts in a large number of companies, each investor can participate in the profits of several companies and has a stake in all such companies. This combined investment fulfils the objective in a better way than the case in which each investor is required to make his own selection of investments. Some investment trusts are formed for the purpose of investing their funds in certain fixed types of industries only. Others may be organized with no such restrictions as to the fields in which to place their investments. Accordingly, investment trusts are classified into two categories : (*a*) fixed trust or unit trust, and (*b*) management trust or investment company.

Before going into the details of these two types of investment trusts, we may note the difference between investment trusts and other kindred institutions like the investment counsel or the holding company. Investment counsels, as the name suggests, are mere advisers on investment

matters ; they advise on the original selection of securities and on the timely shifting of securities for securing increased return on investments or for avoiding risks. Investment trusts sharply differ from holding companies in respect of their objectives. The holding companies invest funds with a view to securing control over other concerns ; and they are required to purchase sufficient voting shares in the companies for this purpose. Devoid of any motive of control, the investment trust purchases any type of securities that appears attractive from the standpoint of safety and yield factors.

UNIT TRUST OR FIXED TRUST : The essential principle of a unit trust lies in purchasing a block of definite securities for permanent holding out of funds provided by financial institutions or collected from the share capital of a new company. The entire block of securities is looked upon as a "trust fund," and it is placed in the hands of the trustee who is usually a well-known banker or an insurance company. The trustee becomes a mere custodian of the securities and has no power to change the portfolio of investments. Against this trusted fund, the trustee is authorised to issue a number of certificates which represent the full beneficial interest of the investment trust. These certificates are sold to the public at a price that covers the cost of securities along with a loading charge. The loading charge represents the cost of organization as well as some profits to the organizers. The trustee collects the income on investments and distributes it among the holders of trust certificates *pro rata*. These trust certificates are known as sub-units, because they are issued out of full scrip values of investment units comprising the trusted fund. There being no market for sub-units or trust certificates, the unit trust is required to buy back these certificates from sub-unit holders.

Advantages of the unit trust are as follows : (*a*) investors have a definite knowledge about composition of trust portfolios ; (*b*) there can arise no loss from mismanagement of the trust ; (*c*) because of the low value of sub-units, small investors find an opportunity to purchase its certificates ; and (*d*) as trustees are usually responsible and reputed institutions, they can exercise effective control over investments in emergencies.

Limitations include : (*a*) the fixity of investments may result in the loss of income and capital ; (*b*) the loading charge may assume a high proportion ; (*c*) profits are distributed up to the hilt, and no reserves are created ; and (*d*) the trust certificates cannot be sold in the organized market.

MANAGEMENT TRUST : What are called management trusts in the U.S.A. are usually known as investment companies in the U. K. The

typical British investment trusts partake of the character of management trusts or investment companies which have made steady progress over a period of the past eighty years. American investment trusts were initially of the type of management trusts, and such trusts were formed in great numbers during 1925-29 for exploiting the investing public. After the financial crash of 1929, the unit trusts were developed in the U.S.A. in replacement of the management trusts. Although unit trusts were formed in large numbers between 1930 and 1940 in the U.S.A., very soon they became unpopular because of high loading charges and unsatisfactory operation. Accordingly, unit trusts have again been replaced by management trusts after the passing of regulatory laws in 1940. In contrast to the unit trust, the management trust avoids the fixity of investments to a selected group of securities. It gives wide powers to the management personnel of the trust both in the original selection of securities and in the subsequent shifting of securities. Consequently, this investment trust is also referred to as *"flexible trust."* As the management team in this investment trust is given full powers on matters of investments, the success of the management trust is entirely dependent upon the capacity and honesty of the management personnel. Moreover, the management trust creates reserves out of its investment income for permitting to give a stable return to its members. In other respects, the management trust is organized on identical lines with the unit trust.

The advantages of management trust are as follows : (*i*) It brings higher and more stable return on its investments due to the flexible policy of investments. (*ii*) It enjoys the benefits of ploughing back its profits and thereby increasing the rate of returns gradually. (*iii*) Constant supervision by an expert management team ensures the transference of funds from an undesirable concern to a safe and profitable concern. (*iv*) It encourages savings and investments in industrial securities on the part of investors. Further, it provides an opportunity for making sound investments to the common investors who cannot make proper selection of securities.

The only limitation is to be found in the character of its management. If management of this trust falls in the hands of incompetent and dishonest persons, the management trust is destined to fail. It may appear as a machinery of exploitation instead of rendering so many benefits. There is enough scope for speculative and manipulative activities available to the persons who control its affairs.

INVESTMENT TRUST IN INDIA : A number of investment trusts were organized in India by managing agents on the basis of limited liability companies. They belonged to the type of management trusts or investment companies and were entirely controlled and managed by

managing agents. Because of the peculiar role of managing agents, the character of investment trusts was transformed into that of holding companies in most cases. Funds of these investment trusts were utilized in pet companies of the managing agents. And investment trusts served as devices for furthering the ends of their organizers. In March 1959, there were 595 investment and trust companies operating in India and their paid-up capital was Rs. 37.7 crores. As the working of investment trusts in India was not very satisfactory, the Unit Trust of India has been set up by the Central Government to enable the small investors to participate in industrial investment.

The Unit Trust of India. The Trust has been established under the Unit Trust of India Act, 1963 with an initial capital of Rs. 5 crores contributed jointly by the Reserve Bank Rs. 2.5 crores, the LIC and the State Bank Rs. 75 lakhs each, and scheduled banks and other financial institutions Rs. 1 crore. The initial capital provided by the participating institutions serves as a base for building a portfolio of securities on the strength of which units can be created and sold to the public. The sale proceeds of units provide the Unit Capital which can be invested further in purchasing securities. The Trust has been organized in February, 1964 and has started the sale of its units from July, 1964. The object of the Trust is to promote savings and investment habit among people and to extend the facilities of investment in equity capital of companies by the large number of small investors. Management of the Trust has been vested in a Board of nine trustees. Of the trustees, the chairman and four other members are nominated by the Reserve Bank, one each is nominated by the LIC and the State Bank, and the other two trustees are elected by scheduled banks. In addition, an executive trustee has been appointed by the Reserve Bank. As regards business activities, the Trust can buy securities of companies and sell its units or repurchase them, but it cannot acquire any immovable property except for its own use. The Trust is authorised to make short-term and medium-term borrowings from the Reserve Bank or other lending institutions.

The face value of the unit cannot be less than Rs. 10 or more than Rs. 100. Initially, the face value has been set at Rs. 10. Units can be transferred to third parties after the close of the first accounting year on June 30, 1965 and they can always be transferred to banks for securing loans. The Trust will be prepared to buy back the units at quoted prices. There will be no limit to the number of units which can be purchased and held by any unit-holder. The gross income and expenses of the Trust are to be allocated proportionately between the initial capital and the unit capital. The entire interest expenses are to be charged against the initial capital and the unit capital in their respective proportions. Other expenses are to be limited to five per cent of the

gross income allocated to the units, the excess amount being charged against the initial capital. After deducting the charges and expenses, not less than ninety per cent of the gross income, as reduced by interest and other expenses, is to be distributed to the unit-holders. Moreover, the unit-holders have been exempt from the payment of income-tax on any income derived from the Trust and other specified investments up to Rs. 3,000 and the Trust itself has been exempt from the payment of income-tax, super-tax and other taxes on its incomes.

For the safety of its invested funds, some guidelines have been provided in the investment policy of the Trust. *First,* the trust cannot invest more than either five per cent of its funds in any one company or ten per cent of the value of securities issued by any one company, whichever is less. *Secondly,* investment in initial issues of new companies is to be limited to five per cent of its investible funds. *Thirdly,* the portfolio of investment is to be balanced by the inclusion of Government securities and industrial securities of debentures, preference shares and equity shares so as to earn an overall return of over 6% per annum.

During the ninth year of its operations ending in June 1973, the total sale of units was the highest at Rs. 23.0 crores since its inception as against the earlier peak of Rs. 22.8 crores in 1969-70. As on June 30, 1973, the total investments of the Trust aggregated Rs. 142.0 crores, of which ordinary shares of companies accounted for Rs. 60.7 crores (43 per cent), preference shares for Rs. 14.9 crores (10 per cent), debentures for Rs. 48.1 crores (34 per cent) and others for Rs. 18.3 crores (13 per cent). At the end of June 1973, the aggregate value of units sold and outstanding with the Trust was Rs. 124.8 crores. The Trust has also engaged itself in underwriting business. It underwrote 14 issues for Rs. 4.58 crores in 1971-72 as compared to 16 issues for Rs. 3.05 crores in the previous year. The Trust distributed dividend among unit-holders at the rate of 8 per cent in 1970-71 and 8.25 per cent in 1971-72. The income distribution to the contributors of initial capital was confined to 5.5 per cent in 1971-72.

The Unit Trust of India has fulfilled a long-felt want in the country, particularly from the side of small investors in the middle-income group of the community. The Trust has provided an opportunity of industrial investment on the part of ill-informed investors by ensuring safety of their capital funds, certainty of fair return, prospect of capital appreciation, facility of liquidation and tax concession on income from this investment. To make its units more attractive to buyers, the Unit Trust of India Act has been amended in 1966 for introducing reinvestment plan and other types of savings plans. Moreover, it is expected to make serious inroads into the working of investment and trust companies of

managing agency houses and to stop their exploitation of common investors for serving their personal ends. In addition, funds of the Trust will be invested in those desirable industries whose development is in conformity with the five-year plans. In spite of so many advantages, some doubts have been expressed in connection with the operation of the Trust. *First,* because of the power of the Reserve Bank to give guidance to the Board of Trustees on policy matters and to nominate the major number of trustees, the Trust will actually operate as a department of the Reserve Bank rather than a separate autonomous institution. This autonomy will be further curtailed by the combination of management functions and trustee functions in a single Board unlike the practice of creating two separate bodies in other countries. *Secondly,* unlike the practice of the U.K. and the U.S.A. where more than 200 kindred institutions operate, one institution in India cannot make much headway. *Thirdly,* income guarantee being 90% of the gross income less interest and other expenses, the unit holders are deprived of any direct capital appreciation on their investment. To be sure, the question of capital appreciation does not arise except in the case of equities and such appreciation can be passed off to the unit holders along with the rise in market prices of covering securities. *Fourthly,* unit holders will have to forego the shareholders' rights which they could enjoy otherwise. *Fifthly,* the expense ratio of the Trust to its total income stands at a very high level of 12 per cent as against the level of 5.5 to 7.5% in the U.K. and 7 to 9.5% in the U.S.A. *Sixthly,* considering the amount of national savings to the extent of more than Rs. 3500 crores, the UTI's average mobilization of savings of Rs. 15 crores per annum appears to be a meagre performance. *Finally,* the investments of the Trust in initial issues and equities call for much acceleration in their proportions.

Industrial Banks. Two successive attempts, one during the Swadeshi Movement of 1906-13 and the other towards the close of World War I, were made in the country for the establishment of industrial banks. But all such banks had to close their doors within a short period of their start. Bereft of any consistent and sound principles to guide their activities, these industrial banks did not survive even the first shock. During the inter-war period, a persistent public demand was made for the establishment of special institutions with State assistance so as to solve the problems of industrial finance in the country. Besides industrial banks which were expected to adopt issue and underwriting business in regard to industrial securities, a further demand was made for the setting up of those industrial mortgage banks which would grant long-term loans to industrial enterprises on the mortgage of their fixed assets. But this demand remained unsatisfied up to the year

1948 when the IFC, the first special institution, was set up in the country. The IFC has been followed by the establishment of several other institutions. As they have adopted the principles of both industrial banks and industrial mortgage banks, the matter has been set at rest.

Insurance Companies and the LIC of India. The insurance companies accumulate large funds which are available for long-term investments. They occupy a significant place in the capital market of a country. Life insurance funds are by far the most important part of the total insurance funds in India, and they constitute roughly 80% of the total funds. The investments of all types of insurance companies in shares and debentures stood at Rs. 59.5 crores at the end of December 1955. Of this amount, the life branch contributed Rs. 51.5 crores, and the balance Rs. 8 crores were contributed by fire, marine and other branches of the insurance business

Following the post-war developments in the U. K., a strong demand was voiced for nationalization of life insurance companies. As a result, nationalization was effected in January 1956. Nationalization was based on the grounds that it would rationalize the insurance business, reduce the cost of operations, ensure a greater safety of life funds, and would enable the Government to utilize the funds in a better way in the public sector and to stop their dissipation by speculative activities in the private sector. Nationalization was opposed with the arguments that rationalization of insurance business and reduction in operating costs could be secured satisfactorily by effecting an amalgamation of companies, not by nationalization. The question of safety of life funds was immaterial, since an unusually heavy percentage of life funds was compulsorily invested in Government securities according to the requirements of the Insurance Act. Moreover, as the distribution of profits was limited to 7½% of the valuation surplus, there was no justification for nationalization.

Industrial enterprises in the private sector must be provided with adequate finance, whether it comes from the insurance companies or from the State. So long as private enterprises are provided with funds, they have nothing to protest against nationalization of life insurance companies. But the available reports indicate that the State-owned Life Insurance Corporation was not supporting the investment market during the first few years to the same extent as the pre-nationalized insurance companies used to do in the past. The investment principles of the LIC have, however, been subsequently adjusted to meet the re-

quirements of private industrial enterprises. The very foundation of nationalization was rudely shaken by official bungling of its funds during the first two years. Remedial measures have been taken to improve matters on investments and to secure the avowed ends of nationalization. The Life Insurance Corporation of India has extended its scope of operation by entering into the business of general insurance and has adopted marine, fire and other branches of insurance business in addition to life insurance with effect from April 1, 1964. The total investments of the Corporation have increased from Rs. 349.29 crores in September 1956 to Rs. 1926 crores at the end of March 1972. Of the total investments, shares and debentures of companies accounted for Rs. 229 crores (11.9%) in 1971-72. The underwriting business has drawn special attention of the LIC and it underwrote 99 issues for Rs. 26.0 crores in 1966-67. In terms of the total amount underwritten during the five-year period of 1966-70, LIC accounted for the largest share of 22 per cent. Moreover the Corporation advanced loans to companies amounting to Rs. 26 crores up to the end of March 1972.

The investment policy of the LIC was enunciated in August 1958 on the basis of Sections 27 and 27-A of the Insurance Act, as amended in 1950. Investments of life funds were divided into three broad categories : Government and approved securities, investments approved under Section 27-A, and other investments. The policy requires that 25 per cent of funds should be held in Government securities, a further sum not being less than 25 per cent in Government or other approved securities and a sum not exceeding 15 per cent in other investments. About 35 per cent of funds is to be held in shares, debentures and other approved investments as per Section 27-A of the Insurance Act. The limit of investment in any one company was extended from 10% to 30% of the equity capital of the company. Investment in private limited companies was also permitted.

Provident Funds Societies. The provident fund collections can be divided into three distinct categories, *viz.* (*a*) funds of the Central and State Government employees, (*b*) statutory funds in specified industries under the Employees' Provident Fund Scheme, and (*c*) non-Government Provident Funds in other industrial establishments. The net collections of all funds come to a sizable amount per annum. Of this, the general provident funds on the part of the Central and State Governments are entirely invested in Government securities. For industries in the private sector, they are of no help. Barring these provident funds, a part of non-Government provident funds is available for industrial investments. And the amount of these funds is gradually increasing as years roll by.

Building Societies. Building societies form an important part of the capital market in Western countries, although the place of building societies in the capital market of India is insignificant. The principal function of building societies is to supply long-term loans on the security of dwelling houses purchased for owners' occupation. Funds of building societies are secured from the investing public who purchase shares in them or make deposits with them.

Special Finance Corporations. The IFC, ICICI, IDBI and other corporations that have been established in the country are referred to as development banks. These development banks have much similarity in the pattern of their organization and their functions. They have been established as autonomous institutions with the active support of the Government and the Reserve Bank of India. They have adopted varied functions for supplying long-term finds to industries by way of promotion, underwriting, mortgage lending, direct subscription to securities and providing technical advice. The reasons for organizing the development banks are many and varied. *First,* there is an absolute dearth of capital in a developing country like India because of its agrarian economy, shyness of capital and low capital formation. *Secondly,* the renovation and modernization programme in Indian industries after World War II assumed such a gigantic proportion as to offer a menacing challenge to the resources of existing financial institutions. *Thirdly,* the ever-increasing need for greater funds in the planned economy could not be met from the ill-organized capital market. *Finally,* financing of small enterprises has been found to be a serious problem in India as in other countries and special institutions and agencies have to be organized for meeting their peculiar needs and problems.

RAISING OF CAPITAL

Raising of capital is effected by different means depending upon the forms of business, the types of capital as well as upon the sizes of the business. Basically, capital comes from ownership funds and borrowed funds. Ownership funds are supplied in the case of unincorporated enterprises in the form of direct contributions by proprietors and partners. In corporate enterprises, ownership funds are supplied by the buyers of shares. Borrowed funds are supplied by a number of lending agencies.

From the Reserve Bank's study on company finances in India, the following table is presented for indicating the sources of financing on the part of public limited companies in India :

SOURCES OF COMPANY FUNDS IN INDIA

(In percentage share to the total amount)

Sources	1956-57 to 1960-61 for 1,001 companies	1961-62 to 1965-66 for 1,333 companies
Paid-up Capital	12.8	9.6
General Reserves	15.6	15.2
Depreciation & other Reserves	27.2	31.9
Long-term Borrowings	12.5	9.6
Bank Borrowings	16.4	18.8
Other Short-term Borrowings including trade credit	15.1	14.9
Miscellaneous	0.4	..
	100.0	100.0

Important sources of capital accumulations in different cases are indicated below :

Fixed Capital for large-sized enterprises—(1) sale of securities, (2) public deposits, (3) term loans, and (4) retained profits.

Working Capital for large-sized enterprises—(1) commercial banks, (2) sale of securities, (3) retained profits, and (4) public deposits.

Capital for small enterprises—(1) ownership funds, (2) finance and development corporations, (3) private deposits, (4) commercial banks, (5) indigenous bankers and money-lenders, (6) co-operative banks, and (7) State assistance.

From the enumeration of sources of capital accumulations, it is apparent that many agencies supply funds for meeting both working capital and fixed capital. Of these different sources, finance and development corporations have been dealt with separately in Chapter 18, and co-operative banks have already been discussed elsewhere. The remaining agencies are discussed in this Chapter in the following order :

1. Sale of Securities
2. Private Deposits
3. Public Deposits
4. Indigenous Bankers
5. Commercial Banks
6. Self-financing (Retained Profits)
7. The State Assistance

SALE OF SECURITIES

With the gradual development of the capital market, the industrial enterprises are relying more upon the sale of securities for raising their fixed capital. The details of sale of securities can be indicated by the amount of capital issues. Reserve Bank's analysis of capital issues in the private sector indicates that during the ten-year period from January 1951 to June 1960, public limited companies other than banking, insurance and financial companies issued equity shares for Rs. 174 crores (68 per cent), preference shares for Rs. 38 crores (15 per cent) and debentures for Rs. 44 crores (17 per cent). During the Third Plan period (1961-65), equity shares accounted for Rs. 262 crores (72 per cent), preference shares for Rs. 30 crores (8 per cent) and debentures for Rs. 73 crores (20 per cent). During 1966-70, equity shares accounted for Rs. 17 crores (51 per cent), preference shares for Rs. 48 crores (14 per cent) and debentures for Rs. 115 crores (34 per cent). Excluding bonus shares, the annual average of capital issues decreased from Rs. 84 crores during 1961-65 to Rs. 74 crores during 1966-70.

The forms of securities adopted by companies in our country displayed an unsatisfactory state of affairs. The capital structure was very ill-balanced in many cases. In 1945, the average proportion of ordinary shares, preference shares and debentures to the capital structure of industries in general was 72%, 20% and 7% respectively, and the balance 1% was contributed by deferred shares. The composition of the capital structure has improved in recent years by the inclusion of greater amount of preference shares and debentures.

Place of Debentures. Debentures have not been used widely by Indian companies in the past. For meeting the requirements of additional funds and reducing the burden of taxation, companies are rather eager to issue debentures on a wider basis in recent years. Although companies are willing to issue debentures, yet there are some factors that prevent them from issuing debentures. The unpopularity of debentures could be traced to the following factors :

Difficulties of the issuing company—(*i*) Because of the high stamp duty, the cost of raising capital in the form of debentures became very high. (*ii*) Companies hesitated to issue debentures which might dry up the bank credit for their inability to offer clean and unencumbered security to bankers. (*iii*) Managing agents used to discourage the issue of debentures with a view to maintaining their financial dominance. (*iv*) The absence of issue houses and underwriting agencies made the marketing of debentures uncertain.

Difficulties of the investors—(*i*) Debentures were usually issued in denominations of Rs. 1,000 each, and as such, common investors could

not purchase debentures. (*ii*) Debentures were not issued with attractive terms ; services of trustees for debenture holders were not generally available, and the securities market could not ensure a prompt liquidity of debentures. (*iii*) As debentures are purchased by conservative investors, the Government securities are more preferred than debentures by those investors. Besides the safety of investments, the Government securities are being offered at present with an attractive yield factor. As a result, there is a general diversion of funds towards savings certificates, plan certificates, etc.

Recent trends—Debentures have acquired popularity for the following reasons : (*i*) the attitude of banks has been revised, (*ii*) they are issued with attractive terms and trustee services are now available, (*iii*) they are easily marketable, (*iv*) they are issued in lower denominations, and (*v*) they reduce the cost of financing.

Foreign Investments. Foreign investments in the private sector in India amounted to Rs. 1253 crores at the end of 1969, of which the U.K. invested Rs. 631 crores and the U.S.A. Rs. 219 crores. Through the conclusion of collaboration agreements with foreign business concerns, the funds have been secured both in the public and private sectors. As many as 3,193 foreign collaborations have been approved by the Government during the period from 1957 to 1970. The number of consents for non-Government companies involving foreign participation stood at 52 and the amount involved in such consents came to Rs. 79 crores during 1966-70. Of this amount, the actual foreign participation came to Rs. 32 crores.

NON-BANKING BORROWINGS

Private Deposits. Private deposits represent the funds supplied by businessmen to their managed companies. The personal resources of businessmen or the resources of their friends and relatives are utilized for fixed and working capital purposes in the enterprise under their control. In the past, managing agents used to supply funds to an overwhelming extent from the birth of the concerns to their maturity. With the abolition of the managing agency system, this source for the supply of capital would be dried up.

The methods that are adopted by businessmen for supplying these long-term and short-term funds for the activities of their managed companies include the following: (*i*) employment of their own funds, (*ii*) collection of public deposits, (*iii*) giving guarantee in respect of bank loans and advances, (*iv*) operation of investment trusts, (*v*) formation of financial integration with banks and insurance companies, (*vi*) inter-company investment of funds, and (*vii*) establishment of joint enterprises with foreigners. The funds

collected through these various methods are invested in industrial enterprises of our country. At one time, these funds were indispensable for the very existence of industrial enterprises, but now this source has become insignificant in character.

Public Deposits. The development of banking on modern lines was delayed by several decades after the beginning of large-scale industries in the country. Because of the absence of banking facilities, the industrial concerns were induced to collect the savings directly from the public, and the funds thus deposited with them were utilized for both working and fixed capital purposes. During the first quarter of this century, public deposits were the most important source of finance for the cotton mills in Bombay and Ahmedabad centres. In comparison with shares and debentures, a greater amount of capital was raised from this source, contributing about 40% of total capital. In the subsequent period, there has been a steady fall in the volume of public deposits. At the present time, public deposits constitute less than 10 per cent of the total capital. The practice of taking public deposits is not an important source of finance in other places of the country.

These deposits are like fixed deposits of the commercial bank ; and depositors are at liberty to withdraw the funds at any time by giving a short notice of withdrawal. When a panic develops in the money market, there is a rush of depositors to take back the amount from industrial enterprises. Consequently, they have acquired the bad name of "fair-weather friends". From the 1940's, the management personnel of cotton mill concerns in Ahmedabad and Bombay have become very cautious about these public deposits. A practice has developed for taking these deposits on a long-term basis ranging from five to seven years instead of the old practice of attracting deposits for a short period varying from six months to one year. The rates of interest and the terms of deposits have tended to become uniform everywhere. Moreover, these deposits today are mostly used for working capital purposes. Another system of finance akin to these public deposits has also developed in Ahmedabad centre. Inter-company deposits between two neighbouring mills have proved to be more dependable than deposits taken from the investing public.

Indigenous Bankers. Before the establishment of banking companies on modern lines, the shroffs, money-lenders and other country-bankers had an unrivalled sway over the whole country. With the development of organized banks, the indigenous bankers have been pushed into the background and their activities are usually confined to giving loans for personal consumption and trading purposes. In some cases, cottage and small-scale industries obtain their short-term credits from indigenous bankers. They charge a prohibitive rate of interest. This makes even small enterprises reluctant for obtaining accommoda-

tion from them. The Bombay Shroffs' Association has, however, claimed that small industries are getting considerable assistance from its members till the present time, and that the total loan transactions of its members come to about Rs. 100 crores per annum. With a view to controlling the unorganized sector of the money market, the Reserve Bank under the Banking Laws (Miscellaneous Provisions) Act of 1963 has been vested with powers to regulate the activities of all institutions including indigenous bankers which accept deposits from the public. For extending the Bank's control to all non-banking companies, two directives were issued with effect from January 1, 1967. The directives provided for the restriction of the acceptance of deposits to 25 per cent of paid-up capital and free reserves in the case of both non-banking financial and non-financial companies. With effect from January 1, 1973, non-banking, non-financial and financial companies have been permitted to accept deposits for a minimum period of 6 months instead of 12 months. The total amount of deposits of 2,211 non-banking companies comprising 676 financial companies and 1,535 non-financial companies stood at Rs. 633.3 crores at the end of March 1970.

COMMERCIAL BANKS

Commercial banks provide the most important source of short-term funds to industrial enterprises. The greater part of the working capital is supplied by them through direct advances in the shape of loans, overdrafts or cash credits and through the discount of commercial papers.

A steady expansion of bank credit to business enterprises is to be witnessed after introduction of the bill market scheme in 1952. This expansion has been effected both in quantitative and qualitative terms. Industrial credit has taken a secular uptrend to support the tempo of industrial development in the country. There has been a phenomenal rise in scheduled banks' deposits and credit from 1960 onwards. At the end of March 1973, deposits stood at Rs. 8,751 crores and credit at Rs. 6,296 crores. The proportion of industrial advance to total advance has also increased significantly from 36.2 per cent at the end of March 1956 to 64.3 per cent at the end of March 1966. Bank advances to industry increased from Rs. 388 crores at the end of March 1956 to Rs. 1,510 crores at the end of March 1966 and Rs. 3,053 crores at the end of June 1972, though the percentage declined to 57.6.

But credit facilities of commercial banks are largely available to large-scale enterprises. Before the nationalization of leading commercial banks, the small enterprises had to suffer much for the denial of bank credit. Small industries had to pull on with their meagre resources or they were forced

to obtain on unfavourable terms from the unorganized money market. The amount of credit extended to small-scale industries by the scheduled commercial banks has increased substantially in recent years. The amount of such credit has increased from Rs. 190 crores in June 1968 to Rs. 639 crores at the end of June 1972. The proportion of banks' credit to small-scale industries has also improved from 6.1 per cent of their total advances in June 1968 to 12.1 per cent of their total advances at the end of June 1972.

Another notable development of commercial banking in the country is to be found in the extension of long and medium-term credit. So long the commercial banks have confined their activities to short-term lending. In recent years, however, the commercial banks have made term-lending to industrial enterprises in a number of ways, *viz.*, by purchasing shares and debentures, advancing long-term loans, underwriting industrial securities, investing in finance corporations and by making advances against corporate securities. Under the leadership of the ICICI, all the leading commercial banks have underwritten one-fourth of total issues for Rs. 35.2 crores during the period from January 1956 to June 1960. During the period from 1960-1963, the banks have underwritten 19 per cent of the total amount of Rs. 68 crores. During 1962-67, banks' share of underwriting came down to Rs. 16.5 crores (9.1 per cent) out of a total amount for Rs. 182 crores in the period. During 1972, 5.2 per cent of shares and 1.4 per cent of debentures were underwritten by banks.

Social Control of Banks. Social control involves a greater regulation of the banking system for meeting the needs of agriculture and small industries more effectively through the equitable distribution of ever-expanding credit. The persistent failure of commercial banks to give adequate financial aid to agriculture and small industries resulted in frustrating the very objectives of economic planning. Bank advances to the agricultural sector came down from 2 per cent at the end of March 1956 to as low as one-fifth of one per cent at the end of March 1966. Likewise, small industries contributing about 30 per cent of the total industrial production received only 5 per cent of the total bank advances to industry. Although the volume and the proportion of bank advances to industry have steadily increased from Rs. 278 crores (36.2 per cent) at the end of March 1956 to Rs. 1,510 crores (64.3 per cent) at the end of March 1966, small industries secured no better deal from the organised banking system. In view of these deficiencies and lapses of commercial banks, an urgent demand was voiced in the country for complete nationalization of such banks. As nationalization was found to be associated with a number of adverse consequences in the economic, administrative and financial spheres, the scheme of social control was introduced from February 1, 1969 for rooting out the lapses of commercial banks. With the nationalisation of commercial banks, the scheme of social control has become defunct.

Nationalization of 14 Banks. Within six months of the implementation of social control, 14 leading Indian banks were nationalized by the Government on July 19, 1969. As social control without nationalization was deemed a fraud and nationalization without social control appeared meaningless, the Government took over the banks on the grounds of (*i*) eliminating the evils of concentration of economic powers in a few hands and preventing monopolies, (*ii*) curbing speculation in commodities and thereby preventing fluctuation in commodity prices, (*iii*) providing greater amount of credit to agriculture and small-scale industries, and (*iv*) mopping up savings on a wider scale through the expansion of banking system in rural areas. The nationalization was opposed on the grounds that (*a*) the operational efficiency and profitability of banks would be destroyed to a great extent, (*b*) compensation for nationalization would involve a huge cost, (*c*) no greater control and better results could be achieved over the pre-nationalized system of control, and (*d*) political interference and official bungling would arrest the proper growth of banks.

The Nationalization of 14 commercial banks raised high hopes and aspirations among the people. Whether the objectives and aims of nationalization can be fully achieved or not would be judged from the progress they could make in the future. During the period from June 1969 to June 1973, they have made excellent progress in some spheres of their working. But there are several other aspects of their operations which call for further improvement. As regards branch expansion, 14 nationalized banks increased their offices from 4,168 in June 1969 to 8,109 at the end of June 1973. In the sphere of direct finance to agriculture, their outstanding amount of credit increased from Rs. 137.8 crores in June 1971 to Rs. 223.5 crores in December 1972. The total credit extended by the scheduled commercial banks to small-scale industries expanded by Rs. 69.5 crores from Rs. 575.5 crores at the end of March 1972 to Rs. 645.0 crores in December 1972. During the same period of March 1971 to December 1971, the credit expansion was only Rs. 48.8 crores. Of the total credit extended to small-scale industries at the end of December 1972, the share of 14 nationalized banks was 48 per cent. But their profitability is showing a disturbing trend. Their involvement in underwriting is also gradually declining. The Banking Commission under the chairmanship of Mr. R. G. Saraiya has submitted its report in January 1972 for improving the working results and operational efficiency of banks, particularly in the public sector. The Commission has recommended for the restructuring of nationalized banks into two or three all-India banks and five or six regional banks. Different regional banks are to act as distinct Lead Banks in different regions of the country.

RETAINED PROFITS

Corporate savings by way of general and specific reserves have become the most important source of capital in the industrial world. The undistributed or retained profits of companies are utilized for meeting the fixed and working capital requirements of enterprises. The process of ploughing back profits for capital purposes is known as "internal financing" or "self-financing". It is the cheapest and most convenient method of securing capital by an enterprise ; the profits are already lying undisbursed with the company, and simply by means of a book-entry, they are retained in the concern permanently. So far as the volume of capital is concerned, the retained profits provide a sizeable portion of additional capital for existing enterprises. In a poor country like ours, corporate savings have become the most significant and potent source of capital formation. Accordingly, self-financing has been encouraged by the Government through the adoption of different measures from time to time. These measures are directed, on the one hand, to increase the amount of profits through the provision of additional depreciation allowances, development rebates or rebates on undistributed profits and to prevent an excessive distribution of profits, on the other, by dividend limitation, progressive taxation of dividend or by compulsory deposit of company reserves.

Fresh equity capital and retained profits are the two principal sources of additional capital for existing enterprises. The relative contribution of these two sources was analysed from a case study of 438 public limited companies by the Taxation Enquiry Commission. The Commission found that during 1946-51 a sum of Rs. 35.4 crores came from external sources, whereas Rs. 68.6 crores were secured from internal financing. In other words, about two-thirds of additional capital was provided by the industrial enterprises themselves. The Reserve Bank's study of finances of 750 public limited companies during the First Plan period indicates that retained profits accounted for 39 per cent of the total profits after tax. The Reserve Bank's study of 1,001 public limited companies during the Second Plan and of 1,333 public limited companies during the Third Plan indicates that the annual average of retained profits came to 44.7 per cent during 1956-61 and 49.1 per cent during 1961-66. Likewise, retained profits accounted for 49 per cent during 1966-71.

Retained profits are desirable from all sides. The company can become financially sound, pay a stable rate of dividend and increase its profits by replacement of equipments or repayment of high interest-bearing loans. Shareholders participate in the increased prosperity of the company ; if they sell the shares, they can obtain a higher market price. If they hold the shares, they can realize an enlarged profit. In

replacement of individual savings, the corporate savings can ensure a greater prosperity of the nation, as it enables industrial enterprises to supply more goods and services at a cheaper cost by their efficient and smooth functioning. But excessive ploughing back is fraught with certain dangers. It may give rise to the concentration of economic powers in the hands of a few persons who are likely to use them against the interests of the community. It may also result in over-capitalization of the company that brings social wastes in its wake. It encourages the growth of industrial demagogues who may be busy in creating industrial empires for promoting their own personal ends. Finally, it interferes with the freedom of investors as well as with the function of the capital market in directing the flow of investments from one industry to another.

Dividend Policy. Internal financing is mainly dependent upon the adoption of a suitable dividend policy. The ownership or capital objective of the business enterprise is required to be fulfilled by the distribution of a satisfactory dividend to the shareholders. But a dividend policy to be regarded as satisfactory must permit the distribution of regular dividends at a gradually increasing rate. The desirable aim of all companies should be the establishment of a stable dividend rate, because it aids in raising additional capital, enhances reputation and increases the value of securities. For the maintenance of a stable dividend rate, the management team is often justified in paying no dividend during the first few years in the case of a new and growing company which requires funds for developing and improving the business.

The distribution of dividend involves some legal as well as financial considerations. From the point of legal considerations, the basic rule is that dividend can only be paid out of profits without making impairment of capital in any way. But the divergent financial considerations present a difficult situation to the management personnel for coming to a decision on dividend distribution. These considerations may be stated as follows :

a. Trend of profits—The past trend of the company's profit should be thoroughly examined to find out the average earning position of the company. The average earnings should then be tempered with the trends of general economic conditions. If the business is approaching a period of depression, only conservative dividend rate can be regarded as prudent.

b. Shareholders' reaction—If the shareholders are widely scattered and numerous, directors lose the confidence of shareholders by withholding dividend payments, and even they may be driven out of office by shareholders. However, when the company is a closely held concern, management incurs no such displeasure. Further, non-payment of divi-

dend in the case of a new company is usually tolerated by the shareholders for the first few years. But it becomes an industrial sin to stop dividend payments for subsequent years by an established company.

c. Requirements of accumulations—Accumulation of profits becomes necessary to provide against contingencies or hazards of the business, to finance future expansion of the business and to modernize or replace equipments of the enterprise. The conflicting claims between dividends and accumulations should be equitably settled by the management personnel.

d. Government's economic policy—The dividend policy is required to be adjusted to the economic policy of the State. The profits of business enterprises are intimately connected with the regulatory and restrictive measures of the Government.

e. Taxation policy—A high or low rate of business taxation may affect the earnings of the company, and thereby its dividend rates. The rates of dividend are usually fixed at such a level that results in the avoidance of payment of penal rates of dividend tax.

The regularity of dividend payment and the uniformity of its rate are the two basic guides to the distribution of dividends. Once the dividend rate is decided upon, management may distribute the dividend either in the form of cash or in the form of bonus shares. The question of cash dividend or stock dividend is settled with an eye to the availability of liquid assets with the concern and the degree of under-capitalization existing in the company.

THE STATE ASSISTANCE

The State assistance has been extended in recent years to large and small industries in a number of cases. This assistance has been given in the direct form of loans or of participation in equity capital for industries in the private sector as well as in the indirect form through the medium of special finance corporations. The indirect assistance is to be witnessed in the supply of capital resources to the IFC and SFCs, deposits to the ICICI and loans to the IDBI and the NIDC. Apart from this indirect assistance, direct State assistance has been given to shipping, iron and steel and chemical industries. The State assistance to small-scale industries is prominent in the case of credit guarantee scheme of the Government of India and of liberalised credit scheme of the public sector banks.

Credit guarantee scheme—The scheme was introduced from July 1960 in 22 approved districts, and it was extended to 52 districts from June 1961 and then to the entire country from January 1963. The objective of the scheme is to provide for enlarged institutional credit to small industrial units by granting a degree of protection to the lend-

ing institutions against any possible loss for such advances. The scheme provides for sharing losses between the lending institutions and the Government of India by way of permitting the lending institutions to recover 75 per cent of the amount defaulted or of the amount guaranteed, whichever is less. The maximum amount that can be recovered under the scheme has now been fixed at Rs. 7.5 lakhs in respect of working capital advances and a further sum of Rs. 2.5 lakhs in respect of term-loans per borrower.

The Reserve Bank of India has been entrusted with the administration of the scheme and has been designated as Guarantee Organization for the purpose. As many as 180 credit institutions comprising all major commercial banks, state financial corporations and co-operative banks have joined the scheme. The scheme was modified in February 1970 for making the guarantee available to all eligible advances on an automatic basis. The guarantees outstanding increased from Rs. 864 crores at the end of March 1972 to Rs. 1,036 crores at the end of March 1973. Since the introduction of the scheme in July 1960 up to the end of March 1973, the credit institutions received an aggregate amount of Rs. 60.1 lakhs in respect of their claims numbering 406.

Bank credit to small-scale industries—The State Bank of India introduced a liberalised credit scheme in 1956 as an experimental measure and the scheme was extended to all the offices of the State Bank of India in 1959. From 1969 onwards, the nationalized banks are also extending increased financial assistance to small-scale industries. The total credit extended by all scheduled commercial banks to 1.22 lakh small-scale industrial units amounted to Rs. 575.5 crores at the end of March 1972. Out of the total credit of Rs. 575.5 crores, the State Bank and its subsidiaries supplied Rs. 226.8 crores (40 per cent), 14 nationalised banks contributed Rs. 283.7 crores (44 per cent) and other scheduled banks gave Rs. 65.0 crores (12 per cent). In addition, the scheduled commercial banks provided term-loans for small-scale industries amounting to Rs. 88.5 crores at the end of March 1972. The amount of term-loans formed about 15 per cent of the total outstanding bank credit to small-scale industries.

CHAPTER 18

SPECIAL FINANCE AND DEVELOPMENT CORPORATIONS

THE INDUSTRIAL FINANCE CORPORATION OF INDIA

Objects and Scope. The first special finance corporation that came into existence in our country was the IFC of India. It is a statutory company set up in 1948 under a special Act of the legislature. The object of the Corporation is to make medium and long-term financial assistance more readily available to those large-scale industrial enterprises which may not secure such assistance from the existing financial market. An industrial enterprise has been defined in a restricted way as to mean any public limited company or co-operative society incorporated in India and engaged in the manufacture, processing or preservation of goods or in mining, shipping and hotel-keeping, or in the generation and distribution of electricity or any other form of power. Small industries have been excluded from the scope of this Corporation as they are intended to be covered by the State Financial Corporations. Private limited companies incorporated and registered in India became eligible for financial assistance from the Corporation by the Amending Act of December 1972.

Forms of Assistance. The Corporation can render its financial assistance in the following six ways :

a. By guaranteeing loans raised by industrial concerns, provided the loans are repayable within a period of 25 years and they are floated in the open market.
b. By granting loans to industrial concerns either directly or through the subscription of debentures, when such loans are repayable within a period of 25 years.
c. By underwriting industrial securities that are usually to be disposed of within 7 years.
d. By subscribing to the stock and shares of industrial concerns.
e. By acting as an agent of the Central Government and the I.B.R.D. (World Bank) in respect of loans sanctioned by them to industrial concerns.
f. By guaranteeing deferred payments on the part of capital-goods importers who are able to make such arrangements with foreign manufacturers.

The IFCI has combined the functions of both industrial banking and industrial mortgage banking ; and it is intended to act as an issue house, an underwriting agency and a credit institution, guaranteeing and granting long-term credits. In order to safeguard its investible funds, the working of the IFCI has been restricted by four different methods. *First,* normally it is not empowered to give any financial assistance without obtaining a tangible security for loan from the borrowing concerns ; and it keeps 50 per cent of the value of security as margin in making loans. But the Amending Act of 1957 enables the Corporation to extend credit without a security when the assistance is required towards the promotion of national interest, and when it is guaranteed by the Central Government, the State Governments, scheduled banks or State co-operative banks. *Secondly,* the IFCI was not to make after December 1952 an advance exceeding Rs. 1 crore to a single borrowing concern without the prior approval of the Central Government. With the formation of the Industrial Development Bank of India in July 1964, the limit of loan assistance to a single industrial concern has been increased to Rs. 2 crores. *Thirdly,* ample powers are given to the IFCI to enforce the terms of its loan transactions by way of liquidating the mortgaged property through sale or lease, taking over management of the borrowing concern, and calling back a loan before the date of maturity. *Finally,* the Corporation, not being akin to a holding company or an investment trust was prevented from directly subscribing to the shares or stock of any company before December 1960. But the Amending Act of 1960 has removed this bar and it can now subscribe directly to shares or can convert its loans and debentures into stock or shares at its option.

Financial Resources. The total resources that can be accumulated by the Corporation come from the sources of (*i*) share capital, (*ii*) debenture capital, (*iii*) public deposits, (*iv*) borrowings in foreign currency, (*v*) borrowings from the Reserve Bank, and (*vi*) borrowings from the Central Government.

The authorised share capital of the IFCI is Rs. 20 crores (raised from Rs. 10 crores in December 1972) divided into 40,000 shares of Rs. 5,000 each. In the beginning, ten thousand shares were issued to raise a paid-up capital of Rs. 5 crores. In March 1962, another four thousand shares were issued to raise a further paid-up capital of Rs. 2 crores. With effect from 1st August 1964, the Industrial Development Bank of India acquired the shares held in the Corporation by the Reserve Bank and the Central Government and it purchased additional shares so as to bring its total holdings up to 50% of the total paid-up capital of the Corporation amounting to Rs. 8.35 crores. The balance 50% shares is held by the Life Insurance Corporation, scheduled banks,

and co-operative banks. In June 1972, the Corporation issued further shares for raising its paid-up capital to Rs. 10 crores. *Secondly,* it can issue bonds and debentures up to ten times the amount of its paid-up capital and reserves. The Corporation has raised Rs. 61.0 crores through the issue of bonds up to June 30, 1972. By the end of March 1973, it issued further bonds of the value of Rs. 11 crores. *Thirdly,* the Corporation can accept deposits from the public as well as from the State Governments or local authorities up to a maximum amount of Rs. 10 crores. The public deposits can only be accepted when they require repayment not before a period of 5 years. Till the end of June 1972, it did not accept any public deposit. *Fourthly,* the Corporation is entitled to borrow in foreign currency from the World Bank and other agencies under the guarantee of the Central Government. The Corporation secured Rs. 22 crores in foreign currency up to the end of June 1972. *Fifthly,* it can make two types of borrowings from the Reserve Bank, one is medium-term accommodation maturing within 18 months up to a maximum amount of Rs. 3 crores, and the other is temporary accommodation maturing within 3 months without any limit. The Reserve Bank charges interest on these borrowings at the prevailing Bank Rate. *Lastly,* the Corporation is also entitled to borrow funds from the Central Government. The outstanding amount of Central Government assistance was Rs. 74 crores at the end of June 1972.

Reserve funds, one general and three special, have been created to strengthen the resources position of the Corporation. The total reserves of the Corporation amounted Rs. 16 crores at the end of June 1972. Moreover, it has access to the IDBI for financial assistance in specified ways. The shares of the Corporation are guaranteed by the Central Government as to the repayment of principal and the payment of a minimum dividend. A higher rate of dividend can be given only when the general reserve fund equals the paid-up capital, and the accumulated deficits arising from the burden of guaranteed dividend distribution are repaid to the Central Government. Likewise, the bonds and debentures are guaranteed by the Central Government as to the repayment of principal and the payment of the fixed annual interest.

Management. With the establishment of the Industrial Development Bank of India, certain changes have been made in the composition of the Board of directors with effect from August 1, 1964. The Board consists of 13 members including the chairman. Of them, the Chairman and two directors are appointed by the Central Government, four directors nominated by the Industrial Development Bank of India and two directors each elected by LIC, scheduled banks and co-operative banks.

Working. The IFCI completed 24 years of its working on June 30, 1972. Since its inception in July 1948 up to 30th June 1972, the Corporation sanctioned financial assistance aggregating Rs. 398 crores. The amount sanctioned was made up of rupee loans Rs. 264 crores, foreign currency loans Rs. 47 crores, underwriting and direct subscriptions Rs. 35 crores, guarantees for deferred payments Rs. 28 crores and guarantees for foreign loans Rs. 24 crores. From the date of inception, the amount disbursed came to Rs. 341 crores on 30th June 1972. Of the assistance sanctioned, 65% of the assistance was for new projects and 35% was for existing concerns. Net assistance sanctioned to 105 projects of co-operative societies amounted to Rs. 87.5 crores up to the end of June 1972. The Corporation extended financial assistance to six public sector undertakings amounting to Rs. 7 crores up to the end of June 1972.

As on 30th June 1972, the amount to the credit of the general and special reserve funds stood at Rs. 16 crores. For the first eight years, the Corporation could not earn sufficient profits even to pay the minimum guaranteed dividend. The lending rate of the Corporation on rupee loans remains unchanged at 9 per cent with the usual rebate of ½ per cent for punctual payment. The rate of interest on foreign currency loans continues to be 9.5 per cent less ½ per cent for punctual payment. The Amending Act of December 1972 calls for the establishment of a special fund known as Benevolent Reserve Fund. In March 1973, the Corporation sponsored the Management Development Institute for providing training to its clients.

Evaluation of Activities. Although the Corporation has not made any spectacular achievement in its grant of financial assistance, it has justified its existence by giving necessary help for the promotion of new enterprises or for the expansion and improvement of existing enterprises. The aim of the Corporation is to supplement the existing capital market and not to supplant it. The charges and criticisms that were levelled against the Corporation in the past do not hold good at the present time. For the first few years, affairs of the Corporation were not conducted on business lines, and the management team was charged with favouritism and discrimination in the extension of loans to industrial enterprises. In respect of advances to the Sodepur Glass Works, the matter came to such a height that the Government found no alternative but to appoint an Enquiry Committee under the chairmanship of Mrs. Sucheta Kripalani. The Committee through its report in May 1953 made several recommendations for the improvement of Corporation's working. The Government has already given effect to most of the recommendations through legislative and administrative actions.

But in matters of policy questions, there are some deficiencies that

have become the subject of common criticisms at the present time. The Corporation has failed to develop a sound and co-ordinated investment policy for guiding its activities over the years in a consistent and steadfast manner. As a result, it has deviated from one direction to another to meet public criticisms or to succumb to the pull and push of pressure groups. *First,* it has by-passed the need of basic and capital goods industries by giving greater emphasis on consumer goods industries and thus it has acted against the programme of industrial development under five-year plans. *Secondly,* the Corporation is intended to give financial assistance to those enterprises which cannot secure such assistance readily from the market. But it has concentrated in giving assistance to those enterprises which could have raised funds from the market easily because of their good earning capacity in the past or of their association with some well-known industrialists. *Thirdly,* large-sized concerns of well-established industries have benefited at the cost of medium-sized concerns of new but promising industries, and accordingly, it has retarded the pace of industrialization in the country. *Fourthly,* balanced development of all regions has been checked by its grant of substantial assistance to a few States with greater concentration of industries. *Fifthly,* as pointed out by the Mahalanobis Committee, activities of the Corporation along with other financial institutions have facilitated the concentration of economic power in a few hands and the consequent growth of monopolies. *Sixthly,* underwriting facilities and supply of equity capital which are prerequisite conditions of industrial development have been neglected over a long period and subsequently relegated to a status of lower importance. *Finally,* lending operations of the Corporation do not correspond with the objectives of the IFCI Act. As to the period of loans, the maximum period has been limited to 12 years in most cases and to 15 years in rare cases. The rate of interest increased from time to time for meeting top-heavy administration has become prohibitive on the part of new enterprises with a long gestation period.

Future. The Industrial Development Bank of India Act, 1964 establishing the Industrial Development Bank in July 1964 has brought about revolutionary changes in the IFCI Act with effect from August 1, 1964. If the future need or further development dictates, the IFCI may become a wholly-owned subsidiary of the Industrial Development Bank which itself is also a subsidiary of the Reserve Bank or the IFCI may be merged in it. Along with the vesting of 50 per cent shares of the IFCI in the Industrial Development Bank, the power of giving policy directives to the Corporation has passed from the Central Government to the IDBI. As the Corporation's dependence on the Central Government is reduced by these amendments, the Corporation will have to

raise funds through its own efforts and to justify its existence in the years to come. Accordingly, some standard conditions and terms of lending operations of the IFCI have been relaxed for expanding its scope of work.

THE STATE FINANCIAL CORPORATIONS

The Central Government passed the State Financial Corporations Act in September 1951 to enable the State Governments to set up local finance corporations in their own jurisdictions for the purpose of meeting long-term credit needs of smaller and medium-sized industries which fell outside the scope of the IFCI. The Act though closely patterned after the IFC of India Act, 1948 made six important departures. *In the first place,* the definition of industrial concern has been widened so as to include not only public limited companies and co-operative societies, but also private limited companies, partnerships or proprietary concerns. *Secondly,* the investing public and non-scheduled banks can subscribe to their share capital up to a maximum extent of 25 per cent. *Thirdly,* the State Corporations can give guarantee and make loans for a maximum period of 20 years as against 25 years of the IFCI. *Fourthly,* they can accept public deposits to an amount not exceeding the paid-up capital of the Corporations unlike the case of IFCI. *Fifthly,* the maximum amount of assistance that can be given by the SFCs to a single concern has been restricted to Rs. 10 lakhs or 10 per cent of the paid-up capital of the Corporations, whichever is less. But the Amending Act of March 1962 permits the Corporations to extend loans up to Rs. 20 lakhs to a single concern in the case of public limited companies and co-operative societies. *Lastly,* the amount of share capital of a State Corporation is fixed by the State Government between the range of Rs. 50 lakhs and Rs. 5 crores.

Functions. Like the IFCI, the State Corporations can render financial assistance to small industrial enterprises by way of (*a*) granting loans and advances, (*b*) guaranteeing loans raised by industrial concerns, (*c*) underwriting industrial securities, and (*d*) undertaking agency functions on behalf of the Central Government, the State Governments or the IFCI. The financial assistance is to be given under proper security that may consist of pledge, hypothecation or mortgage of the assets of the borrowing concerns. But the Amending Act of 1956 permits the State Corporations to give assistance on the guarantee of the State Government, a scheduled bank or a co-operative bank, where the small industries cannot offer sufficient tangible assets for security purposes. The Corporations are vested with certain powers for ensuring efficient management of industrial enterprises, and for the

recovery of loan, control of such enterprises may be assumed by the Corporations.

Financial Resources. Besides the share capital the Corporations are entitled to issue bonds and debentures up to five times the amount of their paid-up capital and reserve funds. The Corporations can also accept public deposits which are not repayable before 5 years. The Corporations are entitled to take short-term loans from the Reserve Bank for a period not exceeding 90 days against Government securities and medium-term loans for periods up to 18 months against *ad hoc* bonds. The shares are guaranteed by the State Government as to the repayment of principal and payment of annual dividend at rates fixed by the State Government in consultation with the Central Government. The bonds and debentures are also guaranteed as to the payment of interest and repayment of principal. The Amending Act of December 1972 permits the Corporations to create a special class of share capital for subscriptions by State Governments and the Reserve Bank of India.

Management. Management is usually vested in a board of 10 directors, out of whom 3 directors are nominated by the State Government, one each is nominated by the Reserve Bank and the IFCI, and four directors are elected by outside shareholders. The remaining one director is appointed as the managing director by the State Government.

Working. At present, 18 State Financial Corporations are functioning in the country. With the increasing demand for loan assistance, some of the Corporations have increased their resources through the issue of bonds. The total amount of outstanding bonds issued by the Corporations stood at Rs. 98.7 crores at the end of March, 1973. Eleven Corporations accepted public deposits and the amount of such deposits came to Rs. 13.6 crores at the end of March 1973. Some of the SFCs made short-term and medium-term borrowings from the Reserve Bank of India. The outstanding amount of such borrowings was Rs. 5.5 crores at the end of March 1973. Five Corporations are working as agents of the State Governments for routing block loans to small-scale industries under the State Aid to Industries Acts and the total of such loans outstanding at the end of March 1973 amounted to Rs. 10.2 crores. All SFCs secured refinance facilities from IDBI and the amount outstanding at the end of March 1973 came to Rs. 52.8 crores. The borrowings of SFCs from State Governments amounted to Rs. 2.6 crores at the end of March 1973.

At the end of March 1973, the paid-up capital of all the Corpora-

tions stood at Rs. 25.7 crores and the total assets at the disposal of all Corporations came to Rs. 229.3 crores. The amount of outstanding loans and advances aggregated Rs. 181.9 crores at the end of March 1973. During the financial year 1972-73, loans and advances sanctioned by all Corporations amounted to Rs. 77.8 crores, against which Rs. 44.1 crores were disbursed. At the end of March 1973, eleven Corporations had investments in shares in fulfilment of their underwriting obligations amounting to Rs. 10.4 crores. Guarantees for deferred payments amounted to Rs. 8.5 crores at the end of March 1973. The lending rates of the Corporations ranged between 7.5 per cent and 9.75 per cent per annum for small-scale industries and between 8.5 per cent and 10.5 per cent per annum for others.

Critical Review. The operations of State Corporations reveal an unsatisfactory state of affairs, and the amount of assistance is not worth the activities of so many Corporations. Some improvement in their workings has, however, been made by amending the Act in 1956 and by adopting other administrative measures. In spite of these steps, they are working far behind the expectations made of them in solving the credit requirements of small industries. The SFCs Act as amended in December 1972 provides for widening their geographical area of operations and enlarging their functions by financing some servicing industries. The State Corporations are confronted with certain difficulties that may be partly responsible for their poor performances. The difficulties may be stated as follows : (1) The assessment of the financial position of the borrowing concerns is a pretty difficult task in the absence of any reliable accounting system. (2) The borrowers do not take the Corporations into their confidence because of the fear of a greater Government regulation and taxation ; and accordingly, they do not provide the necessary particulars of their operations without which the loans cannot be granted by the Corporations. (3) In respect of security for the loan, the non-corporate forms of enterprises offer property for which clear titles are not available, and in some cases, they demand advance solely against stock-in-trade which is outside the scope of mortgage banking, (4) The position and prospects of some small industries cannot be ascertained for want of dependable statistical data. (5) The stability of the borrowing concerns is very uncertain because of the dominance of personal factor in small business. (6) The borrowers do not usually understand the intricacies and technicalities involved in mortgage banking.

Besides the above difficulties, there are *three handicaps* placed by the Corporations themselves. The Corporations charge a high rate of interest varying from 7.5 per cent to 10.5 per cent. In addition to it, the borrowing concerns have to incur incidental expenses like registra-

tion charge, stamp duty, etc., which come to about 3% of the borrowed amount. Thus, the aggregate cost of borrowing reaches a prohibitive level. *The second handicap* lies in overlapping activities of different credit agencies. For the first few years, there were no prescribed operational jurisdictions of various Boards, the National Small Industries Corporation and the State Directors of Industries. The position has now been improved by the fixation of upper and lower limits of loans, as well as by the definition of small-scale industries. *Thirdly,* small industries actutely suffer from the shortages of equity capital and working capital but the Corporations provide them only with loan capital. On the initiative of the Reserve Bank, a draft formula has been evolved for inducing the State Corporations to provide the small industries with some amount of working capital. It has been agreed that 25 per cent of long-term loans may be given for working capital purposes. Wherever funds are not supplied by commercial banks, working capital is to be granted by the Corporations for a maximum period of 5 years. For enabling the small enterprises to overcome their difficulties, they must be provided with venture capital as well as some amount of working capital.

THE INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

The Corporation was registered under the Companies Act in January 1955 to deal exclusively with all types of enterprises in the private sector. Originally, it was entirely a privately owned institution. But with the nationalization of life insurance companies, about 18 per cent of the share capital passed into Government ownership. Today the Government of India is the largest single shareholder of the ICICI. The Corporation had the support of the Central Government from the very beginning, as it obtained an interest-free loan of Rs. 7.5 crores from the Government on a long-term basis. Although the Central Government is entitled to elect one director during the continuance of this deposit, the control of the Corporation rests with the private sector. On the model of the Industrial and Commercial Finance Corporation (I.C.F.C.) of the U.K., this institution was made free from Government control for meeting the needs of industry more effectively, as advised by the World Bank Mission.

Forms of Assistance. The primary objectives of the Corporation are (*a*) to assist in the establishment, expansion, and modernization of private industrial enterprises, (*b*) to mobilise private capital, both internal and external, for the development of industries in the private sector, (*c*) to stimulate the growth of private ownership in industrial

activities. In short, it acts as the champion of the private sector of economy in the country. It can render its assistance to industrial enterprises in the following ways : (*i*) grant of long- and medium-term credits, (*ii*) participation in industrial investment through the purchase of securities, (*iii*) underwriting of industrial issues, (*iv*) guarantee for loans raised from the market, (*v*) supply of funds for re-investment purposes, and (*vi*) provision of technical and managerial know-how in regard to modern industrial process. The Corporation is thus likely to work with the utmost flexibility and can make its assistance tailored in conformity with the requirements of industrial concerns. Its activities amount to the task of securing all-round promotion of industrial enterprises, of which financing is merely an accessory work.

Financial Resources. The financial resources are composed of (1) share capital, (2) borrowings from the Government, (3) borrowings in foreign currency, (4) borrowings from the public, (5) reserve fund, and (6) further issues of shares. The Corporation has an authorised capital of Rs. 25 crores, divided into 5 lakhs ordinary shares of Rs. 100 each and 20 lakhs unclassified shares of Rs. 100 each. Initially all the ordinary shares valued at Rs. 5 crores were issued to domestic and foreign investors. The Indian investors have contributed Rs. 3.5 crores, British investors Rs. 1 crore and American investors Rs. 50 lakhs (70 per cent Indian, 20 per cent British and 10 per cent American). In subsequent years, the other shares of the value of Rs. 5 crores were issued to raise the total paid-up capital to Rs. 10 crores.

The Corporation's net resources at the end of December 1972 amounted to Rs. 299 crores consisting of Rs. 82 crores in rupee resources and Rs. 217 crores in foreign currency resources. The rupee resources consisted of Rs. 10 crores share capital, Rs. 11 crores reserves, Rs. 27 crores loans from the Government of India, Rs. 15 crores advances from IDBI and Rs. 18 crores debentures. The foreign currency resources consisted of Rs. 187 crores from the IBRD, Rs. 3 crores from USAID, Rs. 21 crores from KFW (Germany) and Rs. 6 crores from the U. K. Government.

Management. Management of the Corporation has been placed in the hands of a board of 11 directors. Of the board members, 7 directors represent the Indian shareholders, 2 represent the British and one represents the American, while the eleventh director is nominated by the Central Government. Operative management rests with a full-time chairman and a general manager. The strength of the board may vary from 5 to 15 directors.

Working. Since its inception in 1955 up to the end of December 1972, the ICICI sanctioned a total financial assistance of Rs. 386

crores to 777 enterprises. The total assistance was composed of loans and guarantees Rs. 86 crores in rupee currency and Rs. 225 crores in foreign currency, underwriting Rs. 61 crores and direct subscription Rs. 14 crores up to the end of December 1972. The assistance of the Corporation was broad-based and covered a wide range of industries. The Corporation disbursed a total amount of Rs. 267 crores up to the end of 1972. During the year, the Corporation intensified its activities for assisting small-scale industries and for industrial development of backward regions. It also enlarged its spheres of activities by forming a "Merchant Banking Divisions" for providing adequate services.

The ICICI is a unique institution in the sense that it has pioneered in the field of underwriting operations, equity capital supply and foreign currency assistance to Indian industries. Without the establishment of a formal organization for consortium underwriting, it has been instrumental for developing such joint underwriting in India. The capital market of India has secured qualitative development through its taking a lead in the supply of equity capital to industries. Furthermore, in the context of acute foreign exchange shortage, the Corporation has become the largest supplier of foreign credit within the country. By organizing an *Investment Centre,* the Corporation has encouraged the flow of private foreign investments into India.

THE INDUSTRIAL DEVELOPMENT BANK OF INDIA

Objects and Scope. The Industrial Development Bank of India has been established on July 1, 1964 under a separate statute as an apex institution in the group of term-lending corporations in the country. The formation of the Bank is a milestone in the country's journey to the institutional provision of industrial finance on a long- and medium-term basis. The Industrial Development Bank, being established on the model of the Industrial Development Bank of Canada, is designed to give a new dimension to the industrial finance structure of the country through working as a wholly-owned subsidiary of the Reserve Bank of India. The object of the Bank is to promote the development of very large enterprises by way of mobilising resources of several institutions and to co-ordinate the operations of various term-lending institutions. Four considerations that have prompted the Government to set up the Development Bank explain the crucial and vital role of this institution in the changing economy of the country. *First,* with the mounting tempo of industrialization, the rationalization of the activities of term-lending institutions have been found necessary. *Secondly,* activities of special finance corporations are required to be co-ordinated with the need for short-term credit facilities.

Thirdly, adequate arrangements are to be made for financing those giant enterprises which offer challenge to the resources of one institution. *Finally*, special assistance to industrial concerns has become necessary for securing a far greater diversification of the industrial sector in order to achieve the targets of five-year plans.

Financial Resources. Resources of the Bank can be secured from (*a*) share capital, (*b*) debenture capital and public deposits, (*c*) borrowings from the Government, (*d*) borrowings from the Reserve Bank, (*e*) borrowings in foreign currency and (*f*) the Development Assistance Fund. The authorised capital of the Bank is Rs. 50 crores which may be raised to Rs. 100 crores with the prior approval of the Central Government. The Reserve Bank has contributed the entire paid-up capital which stood at Rs. 40 crores at the end of June 1973. *Secondly*, like other term-lending institutions, the Bank can augment its resources through the sale of bonds and debentures with or without Government guarantee and the acceptance of public deposits having not less than one year's maturity. No limit has been specified in respect of bond issue and public deposit. It secured Rs. 28.7 crores by issuing bonds and debentures up to the end of June 1973. *Thirdly*, the Bank has been granted initially an interest-free loan of Rs. 10 crores by the Central Government and this loan is repayable in fifteen annual instalments after the expiry of 15 years. In addition to the initial loan, the Central Government would grant further loans on usual terms and conditions. At the end of June 1973, total borrowings from the Central Government stood at Rs. 158 crores. *Fourthly*, the Development Bank is entitled to borrow from the Reserve Bank for short periods against trustee securities, for periods up to 5 years against *bona fide* commercial bills or promissory notes and for long periods out of the National Industrial Credit (Long-term Operations) Fund. This new Fund has been established by the Reserve Bank with an initial contribution of Rs. 10 crores which is being augmented by annual contributions of Rs. 5 crores from the year ending June 30, 1965. Apart from giving long-term loans, this Fund may be utilized by Reserve Bank in purchasing bonds and debentures issued by the Development Bank. Total borrowings from the Reserve Bank amounted to Rs. 129 crores at the end of June 1973. *Fifthly*, with Government approval, the Bank can also borrow in foreign currency from foreign banks or other like financial institutions. The IDBI secured from IDA a loan of $ 25 million for financing the foreign exchange requirements of small projects through the SFCs in June 1973. *Finally*, the creation of a special fund known as the Development Assistance Fund is the distinctive method of providing funds to the Bank. The Development Assistance Fund, being built up from initial contributions by the Central

Government, will be augmented by gifts and grants from Government and other sources to enable the Bank to provide assistance to special projects, which for various reasons like heavy investments involved or unduly low rate of return, are not in a position to raise finance from banks or other lending institutions. Assistance from the Fund requires Government approval and a report on the operations of the Fund is to be submitted to the Government through maintaining a separate account of the Fund. At the end of June 1973, the Development Assistance Fund including general reserves amounted to Rs. 25 crores.

Functions. The Bank has been granted wide freedom by its charter in matters of granting financial assistance to all industries both in the private and public sectors, irrespective of the manner of their incorporation. Briefly, it will endeavour to ensure that no deserving industrial enterprise which has a priority in Five-year plans suffers for want of financial resources or other assistance. Financial assistance may be provided to industrial concerns either directly or through the specified financial institutions. Functions of the Bank are summarised in the following groups :

1. It can refinance term loans of 3 to 25 years' maturity given by the IFCI, SFCs and other like notified financial institutions to industrial concerns ; it can also refinance term loans of 3 to 10 years' maturity given by scheduled banks and state co-operative banks ; and furthermore, it can refinance export credits of duration between 6 months and 10 years granted by the specified institutions. In addition to refinancing facilities, the Bank can augment the resources of the IFCI, SFCs and other notified institutions by way of subscribing to their shares and bonds for enabling them to provide larger assistance to industry.
2. It can finance industrial enterprises on its own account like other finance corporations by granting loans and advances or by subscribing to, purchasing or underwriting their securities. Such loans and assistance are, however, liable to be converted into equity shares at the option of the Bank. It can guarantee deferred payments on the part of industrial concerns as well as loans raised by them either in the open market or from scheduled banks, state co-operative banks and term-lending corporations. It can also come to the rescue of such lending institutions by way of assuming their underwriting obligations or by accepting, discounting or rediscounting *bona fide* commercial bills or promissory notes of industrial concerns.
3. The Bank is intended to enter into new fields of activities and to set up new standards of constructive and imaginative endeavour for filling gaps in the industrial structure of the country.

The Bank can undertake marketing and investment research, carry out techno-economic studies and promote the establishment of new industries. It can also provide technical and administrative assistance to any industrial enterprise for securing promotion, expansion or diversification thereof.

Management. Management of the Bank vests in a Board of Directors assisted by an executive committee, a chairman and a vice-chairman. The same members who constitute the Central Board of Directors of the Reserve Bank of India have formed the Board of Directors of the Development Bank. The Governor and a Deputy Governor of the Reserve Bank have assumed the functions of Chairman and Vice-chairman of the Bank. An executive committee of directors may be created for discharging such functions as may be delegated to it, and other special committees may be constituted by the inclusion of directors and other persons for undertaking responsibilities in different areas of the Bank's operation.

Working. The Development Bank started functioning from July 1, 1964, and with effect from August 1, 1964, it has brought about revolutionary changes in the constitution and character of the IFCI. The IFCI has become a subsidiary of the Development Bank which holds 50 per cent of the total share capital of the Corporation and has the power of giving policy directives and providing financial assistance to the Corporation. Moreover, the charter of the Bank has made provision for the merger of the IFCI with the Bank or its conversion into a wholly-owned subsidiary of the Bank, if necessity arises in future. The Refinance Corporation for Industry has been merged in the Bank on September 1, 1964, and it has ceased to function as a separate institution from that date. As the Refinance Corporation for Industry was working under the guidance and influence of the Reserve Bank, its merging with the Bank may not have such significant consequences as in the case of the IFCI.

The assistance of the IDBI is given in the direct form of loans and underwriting as well as in the indirect form of bills rediscounting, refinancing, guarantees and subscription to securities. During the period from July 1964 to June 1973, the IDBI sanctioned an aggregate financial assistance amounting to Rs. 775 crores and disbursed a total amount of Rs. 565 crores. Assistance outstanding at the end of June 1973 was Rs. 368 crores. Guarantees for loans and deferred payments amounting to Rs. 28.5 crores were sanctioned up to the end of June 1973. The amount of direct assistance outstanding on June 30, 1973 by way of underwriting and loans stood at Rs. 114 crores. The outstanding amount of refinance stood at Rs. 81 crores on June 30, 1973.

The outstanding amount in respect of bills discounted and direct subscriptions stood at Rs. 109 crores and Rs. 34 crores respectively at the end of June 1973. Refinance of industrial loans for backward areas amounted to Rs. 32.4 crores up to the end of June 1973. The lending rate of the IDBI has been raised to 9 per cent from 8.5 per cent with a penalty charge of ½ per cent for default. In addition, a commitment charge is also levied. The Amendment to the IDBI Act of 1964 passed in December 1972 has vastly expanded the scope of its activities.

Evaluation. The Development Bank has been launched with high hopes and great expectations. As it is supposed to go in for untrodden and untractable path in its venture of paving the way for rapid industrial development, it has been made free from the shackles of many controls, restrictions or handicaps that are usually faced by other term-lending institutions. Because of the magnitude of its tasks, doubts have been expressed by many whether the overburdened Central Board of Directors can devote requisite time and effort for the work of the Development Bank. *Secondly,* other term-financing institutions could have made excellent progress if they were granted the same amount of freedom as in the case of the Development Bank and their incomes or profits were made free from the payment of any tax like the Development Bank. *Thirdly,* the charter of the Development Bank does not spell out the relationship between this institution and the National Industrial Development Corporation. These two institutions have the same objective and nature of working and their operations are bound to overlap and create duplication. It would have been better for the Bank to absorb the NIDC first.

INDUSTRIAL RECONSTRUCTION CORPORATION OF INDIA

Objects and Scope. The Industrial Reconstruction Corporation of India has been set up as a public limited company in April 1971. The primary objective of the Corporation is to revive and revitalise the industrial units which have been closed down or which are on the verge of closure. Rather than being a mere lending agency, the IRCI has been conceived as a reconstruction agency for diagnosing and removing all shortcomings which led to the failure of industrial concerns. The role calls for reorganization of management structure, provision of technical, financial and managerial guidance, arrangement of financial assistance from banks and other financial institutions, solution of labour-management problems and a host of other like activities pertinent to the operations of industrial concerns.

Functions and Forms of Assistance. Assistance from the Corporation can take the form of guarantees and soft loans having maturity

between 4 and 12 years. Reconstruction loans are not granted for repaying the existing debts of industrial concerns. They are granted for meeting the essential capital expenditure, paying off pressing liabilities and filling the liquidity gap. Both corporate and non-corporate enterprises are entitled to get assistance from the Corporation. For exercising better control, however, the IRCI suggests conversion of non-corporate forms to limited companies. The amount of reconstruction assistance has been limited to Rs. 50 lakhs in any individual case and to Rs. 50 crores in the aggregate at any one time. The Corporation charges 8.5 per cent interest per annum on its term loans. For small-scale units, the interest charge is reduced to 7.5 per cent. For units located in backward areas, the concessional rate of 7 per cent per annum is charged. On the amounts of guarantees executed, charges are levied at one per cent per annum.

Financial Resources. The authorized capital of IRCI is Rs. 25 crores, of which Rs. 10 crores have been issued and subscribed by IDBI, LIC, ICICI, SBI and 14 nationalized banks. The Corporation's paid-up capital amounts to Rs. 5 crores. Apart from the share capital, an interest-free loan of Rs. 10 crores has been secured from the Government of India and the loan is repayable in 15 equal annual instalments after the expiry of 15 years. IRCI can also make borrowings from the Reserve Bank of India and the Industrial Development Bank of India. It can make borrowings from the market like other term-lending institutions.

Working. IRCI started its operations in April 1971. From its inception up to the end of March 1973, IRCI has sanctioned Rs. 12.3 crores to 64 sick/closed industrial units employing a total labour force of 47,600. More than one-half of the sanctioned assistance was in respect of units in the engineering industry and the textile industry claimed about 10 per cent of the amount sanctioned. Utilization of assistance up to the end of March 1973 amounted to Rs. 5.7 crores. Moreover, the IRCI has arranged for financial assistance of the order of Rs. 7.6 crores from banks for meeting the working capital needs of sick concerns up to the end of March 1973.

Starting its operations in West Bengal, IRCI has extended its activities to other States and Union Territories such as Andhra Pradesh, Maharashtra, Delhi and Kerala in the second year of its operations. It has promoted a central textile processing unit of the modern type. It is also maintaining its active association with the running of those units which are taken over by the Government of India under the Industries (Development and Regulation) Act, 1951.

For safeguarding its investments, IRCI exercises three groups of

control measures. *First,* it asks the borrowing concerns to transfer their 51 per cent or more shares in its name. *Secondly,* it appoints its nominees on the board of directors of the assisted concerns, it exercises control over the appointment of key managerial personnel and it insists on having its nominees on the purchase and sales committees of industrial concerns. *Finally,* it calls for the submission of periodical progress reports and arranges for the actual visits to the plants. It makes frequent review of the working of assisted concerns.

THE NATIONAL INDUSTRIAL DEVELOPMENT CORPORATION

The National Industrial Development Corporation was set up by the Government of India in October 1954 for the promotion and development of industries in the country. The Corporation is designed as an instrument of the Government for securing a balanced and integrated development of industries in both the public and private sectors. It is out and out a promotional organization at the State level intended to look after the growth of some industries that can fill the gaps in our industrial structure. With this end in view, it formulates projects after necessary study and investigation for setting up new industries or new lines of production in existing industries and implements the projects with the utmost use of internal resources of the country. The projects are executed either by the Corporation itself or in collaboration with private enterprises. When the promoted enterprises reach a stage of maturity, they may be handed over to the private sector of the economy. This method of "self-liquidating" investment would enable the Corporation to take up further and increasing responsibilities for new promotions.

The authorised capital of the Corporation is only Rs. 1 crore, out of which Rs. 10 lakhs have been paid up. As it will have funds made available by the Central Government from time to time, a greater amount of capital has been considered unnecessary. Moreover, it is empowered to increase its resources by issuing bonds and debentures or taking deposits and advances from any sources. The Central Government provides funds in two ways ; annual grants for recurring expenses and *ad hoc* grants for execution of projects.

The Corporation can render assistance on its own accord to any industrial concern, whether it is owned and managed publicly by the State or privately by individual interests. For the development of industries, its assistance can be tailor-made in the forms of capital, credit, machinery, equipment or skill. Management of the Corporation is vested in a board of Government nominated directors, the number of whom may vary from 15 to 25. By the inclusion of industrialists, scientists, and other experts on the board, it endeavours to integrate the development of public enterprises with industries in the private sector.

The Corporation has been authorised by the Government to undertake the execution of two major groups of projects relating to : (*a*) the manufacture of industrial machinery in the field of heavy engineering ; (*b*) some important industrial materials like raw film, aluminium and synthetic rubber as well as primary intermediates for the drug, dyestuff and plastic industries. It gives priority to the establishment of capital goods industries which in turn may stimulate the growth of ancillary industries. Further, the NIDC was acting as an agent of the Central Government in granting loans for the modernization and rehabilitation of cotton and jute textile industries. It also undertook the task of advancing loans to enterprises engaged in manufacturing machine tools. The Corporation was directed by the Government not to entertain fresh applications for loans from February 1963. Accordingly, in respect of rehabilitation assistance, the activities of the Corporation have been restricted to making disbursements of loans already sanctioned by it. Up to 31st January 1963, the Corporation sanctioned loans aggregating Rs. 27.7 crores to cotton textile, jute and machine tool industries for modernization. Of the sanctioned amount, total disbursements came to Rs. 18.6 crores up to the end of March 1970. Besides, the Corporation was giving short-term financial assistance to textile industries for acquiring indigenous machinery and for installing imported machinery. The work of considering loan applications from cotton textile and jute mills has been entrusted to the Industrial Development Bank of India.

A number of Government companies have been established for executing different projects undertaken by the Corporation. For organic chemical intermediates, the Hindustan Organic Chemicals Ltd. has been set up in December 1960 with an authorised capital of Rs. 12 crores. For film project, the Hindustan Photo Films Manufacturing Co. Ltd. has been set up in November 1960 with an authorised capital of Rs. 3 crores ; and for the production of sulphur from pyrites, the Pyrites & Chemicals Development Company (Private) Ltd. has come into existence in March 1960 with an authorised capital of Rs. 5 crores. For drugs project, a separate company under the name of the Indian Drugs & Pharmaceuticals Ltd. has been established with an authorised capital of Rs. 15 crores. The project relating to heavy machine building has been entrusted to the Heavy Engineering Corporation in November 1960. For providing engineering and consultancy services, a separate Technological Consultancy Bureau is functioning under the auspices of the Corporation. The Bureau is now engaged in making investigations of a number of projects like the Precision Instruments Plant, Pumps and Compressors, Ball & Roller Bearing Project, Aluminium Project, Bio-Gas and Bio-Fertilizer Plant.

THE NATIONAL SMALL INDUSTRIES CORPORATION

On the recommendations of the Ford Foundation team of experts on small industries, the National Small Industries Corporation was formed in February 1955 as a private limited company with an initial capital of Rs. 10 lakhs (subsequently raised to Rs. 50 lakhs) entirely provided by the Government. It can assist only those small industries which have a capital investment up to Rs. 7.5 lakhs in ordinary cases and up to Rs. 10 lakhs in the case of ancillaries to large industries. The objects of the Corporation are : (*a*) to allocate some Government contracts to small units, (*b*) to provide machinery and equipment on hire-purchase system, (*c*) to supply raw materials with convenient central storing arrangement, (*d*) to improve marketing organization in the rural areas, and (*e*) to administer the prototype production and training centre. Separate divisions have been created for executing different work, *viz.*, a Stores Purchase Division, a Hire-purchase Division, a Marketing Division, a Division for Industrial Estates as well as a Division for Administration and Accounts. Further, it aims at securing necessary co-ordination between large-scale and small-scale industries so as to enable the latter to manufacture ancillaries and components for the large industries.

With a view to decentralizing its activities and securing a harmonious operation of other agencies for the development of small industries, four subsidiary Corporations established on regional basis at Bombay, Calcutta, Delhi and Madras have started functioning from April 1957. Moreover, the Small Industries Service Institutes have been set up in several centres of the country as the "thinking cell for the further development of small industries." The functions of these institutes are to render expert advice to small industries for the improvement of their production, marketing and management techniques and to assist them in obtaining machinery, credit, raw materials and other requisites. The Service Institutes render broadly two types of services : technical services and commercial services. This organization as a whole does not advance loans to small units on its own account, but it is of great help in procuring State aid from the local Directors of Industries or loans from the State Bank, the co-operative banks and the State Financial Corporations.

During 1972-73, the Corporation supplied machines to small-scale units of the value of Rs. 9.2 crores. The rate of interest charged is 9 per cent per annum with rebate of 2 per cent for punctual payment. The instalments which had gone into defaults till the end of March 1973 amounted to Rs. 6 crores. The raw material depots of the Corporation distributed different types of raw materials worth Rs. 2 crores to small-scale units located in the Union Territories of Delhi and Pondicherry. During 1972-73, 1886 contracts worth Rs. 37.8 crores

were secured by the small-scale units through the assistance of the Corporation. As many as 738 small-scale units were enlisted by the Corporation during 1972-73. A special Export Cell was created by the Corporation to identify the existence of export potentiality of the small-scale industries. In the export field, the Corporation effected a sale of Rs. 1.4 lakhs during 1972-73.

CHAPTER 19

SHORT-TERM FINANCING AND CREDIT INSTRUMENTS

NATURE AND EXTENT OF CREDIT

Credit is the privilege to buy now and to pay at some future time. The future paying capacity is the controlling factor of credit, and it determines the grant of credit as well as the extent of credit. Confidence in the paying capacity is said to be the foundation of credit, and it arises from the four C's in credit—(*a*) capital, (*b*) capacity, (*c*) character, and (*d*) conditions. The credit standing of an enterprise is judged with reference to all the four factors which are of equal importance. The amount of capital invested or owned by the debtor is the first material question to the creditor. The capacity of business is expressed by the present financial position of an enterprise. Character of the debtor is concerned with honesty, integrity and punctuality in the repayment of debts. However, character is a more important consideration in proprietorship and partnership business than in the company business. The last factor has to do with general economic conditions prevalent at the time of credit sanction. In the context of existing economic conditions, the future business trend along with the probable capacity of the borrower is interpreted by the creditor.

It is argued by some that when an adequate security is furnished for a loan, there should arise no other considerations in granting credit. But such arguments do not find favour with the bankers and other lenders, because they are not willing to assume the task of selling the pledged security which is an entirely different work from their own. To safeguard the investments and their ultimate repayments, the bankers are compelled to accept security. But appropriation of the security is not their desired end. It is for this reason that other factors are taken into consideration in the extension of credit.

Credit is widely used in business transactions and constitutes by far the most important part of total transactions. Cash sales are comparatively more important in retail business than in the wholesale or the industrial business. Wholesale purchases are made from a distant place without inspecting the goods that are produced by any industrial concern. The credit mechanism has simplified the marketing process to a great extent. The wholesaler purchases goods by description and the producer gets the payment in due course through the medium of some

form of credit. The physical transfer of cash money and the accompanying risks are eliminated by the process. The arrangement appears satisfactory to both the buyers and the sellers of goods. In retail trade also, the retailers are forced by circumstances to accommodate some of their clients with the grant of credit facilities through the schemes of hire-purchase and instalment sale. Present-day business on such a gigantic scale would have been impossible without the use of credit. It must be recognized that the vast and complex business activities of the present age are based on the superstructure of credit.

Credit Information. The grant of any credit to a party must be preceded by an adequate information about his credit-standing or credit-worthiness. With this end in view, most of the concerns maintain a separate credit department which is entrusted with the work of collecting information about their customers from various sources. The principal sources are (*a*) references given by customers, (*b*) bankers' opinions, (*c*) commercial enquiry agents, and (*d*) trade directories published by different concerns.

References given by the customer as well as the information supplied by the customer himself may be regarded as direct sources. In the case of new customers only, the question of reference arises. A new customer is usually asked to give the names of two persons who can certify his credit-standing. These direct sources are, however, utilized for obtaining information in respect of present financial position, past performance, future prospects and character of the customers. Customers' statements of present financial position are also verified with their respective balance sheets and profit and loss accounts.

Bankers' opinion is a very important source, as the local commercial banks have an intimate knowledge about the financial position of persons in their respective jurisdictions. But because of their confidential relationship with the customers, the commercial banks generally do not give full information relating to the credit-standing of a party. They supply some general information that may help in deciding how much credit can be safely extended to a party. The *third source* is not available in our country. In the advanced countries like the U.K. and the U.S.A., specialized agencies have been established for giving information as to the financial status of different enterprises. *Lastly,* trade directories containing valuable trade information are an important source of credit information. These publications are usually made both by the Government and by private concerns. In this respect too, the position is not satisfactory in our country. Some non-Government publications are available, but they are not up to the mark, *e.g.*, Stock Exchange Year Book, Thacker's Trade Directory, etc. Credit information can be vastly improved by an up-to-date and exhaustive Govern-

ment publication. Some Government-controlled term-lending institutions should undertake this task without any further delay. By this publication, the IFCI or the IDBI can render one of the greatest services to the country through the supply of reliable information for the guidance of different lending agencies.

Credit Analysis. Only the credit-standing of an enterprise is ascertained by credit information, but it does not help in deciding upon the amount of loan that can be extended from time to time. For this purpose, credit analysis is made by the lending concerns. The following four important methods of credit analysis may be stated.

i. *Ratio of current assets to current liabilities*—This ratio gives an indication of the capacity of a concern to repay its short-term loans. As explained elsewhere, the lenders expect the current assets to be at least double the amount of current liabilities in normal cases.

ii. *Ratio of cash to current liabilities*—Another safety test that is applied by the lenders is to be found in the analysis of relative cash position. According to the nature of the business, a minimum of 10 to 20 per cent of the current liabilities is to be kept in the form of liquid assets.

iii. *Ratio of inventory to current assets*—A lending agency hesitates to extend credit if more than half of the current assets are absorbed in stock-in-trade. Except in the case of seasonal industries, if an unusual percentage of current assets is tied up in inventories, the capacity to repay loans is seriously weakened.

iv. *Ratio of sales to inventory*—Sales are compared to merchandise inventory so as to find out the relative speed of inventory turnover. This inventory turnover is ascertained for a number of years for finding out the comparative progress of an enterprise. Similarly, sales may be compared to bills receivable or book-debts to find out their turnover rates.

FORMS OF CREDIT

There are several kinds of business credit which may be classified under the headings of : (*a*) bank credit, (*b*) open-account credit or trade credit, (*c*) instalment credit or consumer credit, and (*d*) commercial paper or negotiable instruments.

Bank Credit. Commercial banks, directly or indirectly, supply the bulk of short-term credit requirements of the business. Although trade credit assumes a very high figure in actual business transactions, a great part of this trade credit is supported by commercial bank credit. A line of credit is to be opened for the purpose of securing bank credit.

The line of credit represents the upper limit of borrowing fixed by any banker for an individual concern, and it is determined by the ratio of free current assets to current liabilities of the concern. It is the usual practice of a concern to keep about 20 per cent of its line of credit in the form of deposits with the bankers.

Bankers extend credit to their customers by way of direct advance or discounting bills. Direct advance may take place in any one of the three ways—overdrafts, cash credits and loans. *Overdraft* is a kind of temporary accommodation extended by the bank to its customers. Under this method, the customer is allowed to overdraw his current account usually against collateral securities and is charged interest on the amount so withdrawn. *Secondly,* cash credit is an arrangement under which the customer is allowed to draw funds up to a certain maximum amount as and when he requires money. Such credit is fully secured by the lodgement of collateral securities. The customer is required to pay interest on the amount actually utilized by him, not on the maximum amount agreed to be advanced. The cash credit system is very popular in our country, and the majority of advances is given under this method. *Thirdly,* when the advances are given in the shape of outright loans, a loan account is opened in the name of the customer, and the entire amount is transferred to his current account so that the customer can use the funds freely. These loans are also granted against collateral securities ; but the customer is required to pay interest on the full amount, whether he uses it or not. Before the introduction of the bill market scheme, discounting of bills was not an important method for advancing funds. *Discount operations* involve the purchase of commercial paper at an amount somewhat less than the face value before the date of maturity. The difference between the present value and the face value is the amount of discount charged by the bank.

Bank credit may be a secured or an unsecured one. Commercial papers like bills, promissory notes or hundis are written evidences of indebtedness containing promises of one or more persons. Whether they are single-name or double-name papers, any credit extended against these papers may be regarded as unsecured loans, since reliance upon the papers is entirely based on the word of the parties. The commercial banks in our country do not extend much of their credit facilities by way of unsecured advances. Although the commercial banks of other industrially advanced countries make more than half of their advances in the unsecured form, banks in India make as low as one-sixth of their transactions in the form of unsecured advances. Absence of credit information facility is mainly responsible for this situation. The major portion of bank credit is covered by some forms of tangible securities which serve as collateral for the loans. The usual forms of collateral security are actual merchandise, documents of title to

merchandise, industrial and Government securities, bullion and real properties.

Merchandise may be pledged or hypothecated to the banks as the security for a loan. In the case of pledging, the bank takes over the possession of merchandise from its customers. But in the case of hypothecation, the merchandise remains with the borrower and only an equitable charge against the goods is created in favour of the bank. The scheduled banks prefer hypothecation and non-scheduled banks adopt pledge for the purpose of taking merchandise as security. The documents of title which carry ownership of goods form a very good collateral for bank credit. The documents of title to goods under the Indian Sales of Goods Act mean "a bill of lading, dock warrants, warehouse-keeper's certificate, wharfinger's certificate, railway receipt or order for the delivery of the goods and any other document used in the ordinary course of business as proof of the possession or control of the goods." Government securities are a favourite form of collateral with our bankers who are reluctant to take industrial securities instead. In the interest of industrial development of the country, the commercial banks have to revise their policy of giving undue preference to the Government securities. Recently, much leeway has been made in this respect. Landed property and bullions are occasionally taken by the non-scheduled banks as security for granting advances.

Trade Credit (OPEN ACCOUNT). For the sale or purchase of goods, trade credit is extensively used everywhere. The goods are sold "on account" of the buyers who enjoy the credit for an usual period of 30 to 90 days. Different customers' accounts are opened in the books of seller for recording this grant of credit. Although no separate interest charge is made for trade credit, the higher price of the goods covers interest on this type of credit.

There are several advantages which can be secured by an enterprise in granting trade credit. The selling company creates permanent customers who make repeat purchases, and the pressure of competition is thereby reduced. Trade credit provides the satisfactory and convenient means of making payment for the goods. Both the buyers and sellers are relieved of the trouble and risk associated with cash transactions involving large amounts. But trade credit facilities are beyond the means of some sellers, because they involve larger working capital, higher operating cost and greater amount of bad debts on the part of sellers.

Instalment Credit (CONSUMER CREDIT). Instalment credit is a distinct type of credit as compared to the open account credit. Unlike trade credit, the customers do not pay within a short period, but the payment is spread over a considerable time. Further, goods are sold

under instalment credit to the ultimate consumers, but trade credit is granted by one enterprise to another. For the sale of high-priced consumer goods, business enterprises extend a form of credit under which the consumers are required to pay the price in different instalments, and hence it is known as instalment credit. It calls for heavy collection expenses and laborious record keeping. Accordingly, a higher price is charged for covering the extra expense incurred by the seller. And the seller must have sufficient capital collected from his personal resources as well as from bank credit.

Instalment credit is extended in two different ways : *hire-purchase system* and *instalment sale.* (*a*) True to its name, hire-purchase looks upon the consumer as the hirer of the goods until the full price is paid by him. That is, the possession of the goods is transferred, and not the ownership which is retained by the dealer. If the buyer fails to pay even one instalment, the product is taken back by the seller without any consideration for the sum already paid by the buyer. Because of its unfavourable terms to the buyer, an alternative system of instalment sale has been developed. (*b*) Instalment sale involves outright sale of the product through the transference of both ownership and possession from the very beginning when the first instalment is paid. But it is looked upon as a conditional sale inasmuch as the ownership of the goods reverts back to the dealer on failure of the buyer to pay regular instalments. Unlike the hire-purchase, it does not appropriate the amount already paid by the buyer in the form of some instalments.

There are several merits and drawbacks of sales under instalment credit. The greatest advantage lies in the promotion of sales. It is a technique of sales designed to push the goods ahead of rival concerns among the prospective consumers. To tempt an ever-increasing number of persons to buy goods, the system accommodates the consumers with the best possible credit. Many of the products would have remained unsold if the buyers were required to pay the entire price of the goods immediately. Because of this system of easy credit, comparatively poorer section of the community can go in for some costly goods which would have been otherwise inaccessible to them. It encourages an economy in other expenses so as to meet the regular instalments. But, as an inducement to purchase goods, the system may force the buyers to live beyond their means. By the professed facility of easy credit, it may pass off goods of doubtful quality. Again, it exacts a much higher price from the consumers. Finally, a large amount of capital is required to finance this retail sale, and the dealer has to bear the risk of bad debts and the extra cost of running his business.

Negotiable Instruments. Cheques, bills and promissory notes are negotiable instruments of credit, and they are known as commercial

papers. They provide a more convenient and effective means of making a prompt settlement of the debt than any other forms of credit. Some instruments bear a definite maturity date ; others are payable on demand, at sight or at a given number of days after sight. The negotiable instruments facilitate business transactions in various ways : they serve as a substitute for money in the exchange of goods and services and make the available supply of money more effective.

Characteristics—The negotiable instruments pass freely from one person to another in accordance with the established rules and practices. Accordingly, they must be drawn up and transferred in conformity with the statutory rules and customary practices, otherwise they would tend to restrict the business transactions rather than facilitating them. Certainty is the basic ingredient of the negotiable instruments. This certainty is expressed in various ways : (*a*) there should be no doubt about the drawer or maker of the instrument, and for this, the instrument must be evidenced in writing under his signature ; (*b*) there must be a specific promise to pay some definite and fixed sum of money ; (*c*) the payment is to be made on a certain date which might be determined on demand, at a specified time, or at some other ascertainable time ; (*d*) the instrument must be made payable to a specified person or to the bearer thereof ; and (*e*) when it is drawn upon a specific person or company, the identity of that person or company must be established.

CHEQUES

"A cheque is a bill of exchange drawn on a banker payable on demand" (Negotiable Instruments Act). This definition of the cheque is linked up with that of a bill of exchange. To give an independent definition, it can be said that a cheque is an unconditional order in writing made by a customer to his banker to pay on demand a stated sum of money to the person named in the cheque or to the bearer thereof. On analysing this definition, a cheque is found to contain seven requisites : (*a*) an unconditional order, (*b*) expressed in writing, (*c*) made by a banker's customer, (*d*) drawn upon a banker, (*e*) involving payment of a fixed sum of money, (*f*) payable on demand, and (*g*) to the person named therein or to the bearer thereof.

Drawing of Cheques. Cheques are always drawn upon a bank by its customers who maintain accounts with the bank. The person who draws or issues the cheques is called the "drawer", the person to whom the cheque is made payable is known as "payee", and the bank on which a cheque is drawn is referred to as the "drawee". The drawer and payee may be the same person when the cheques are made payable to 'self'. For the drawing of cheques, the drawers are required to observe the following formalities :

Date—Every cheque form supplied by the banker is provided with a space for entering date on the top right-hand corner. The current date is normally inserted in the allotted space. But a past date or a future date may also be used on the cheque. Cheques bearing a date subsequent to the date of issue are known as post-dated cheques, whereas ante-dated cheques involve the use of one such date that has already passed. In the case of a post-dated cheque, the date is yet to arrive; and until the date given comes off, the payee is not entitled to the payment of the cheque. When a cheque bears a past date, it may be paid by the banker provided the cheque does not become a stale one. An ante-dated cheque becomes a stale cheque on the expiry of three months from the date of drawing. Stale cheques are paid only when they are confirmed by the drawer. As a matter of practice, the banker demands confirmation by the drawer even if there is an unreasonable delay in presenting the cheque.

Payee—The second formality is concerned with the writing of payee's name in a correct and legible way. In giving the name of the payee, titles of honour and academic degrees should be avoided.

Bearer or order—The drawer has to indicate next whether he wants to make the cheque a bearer or an order one. The cheque payable to a certain person 'or order' is called an order cheque, and the cheque payable to a certain person 'or bearer' is known as a bearer cheque. When the cheque is to be paid to the 'payee only', it is also deemed as an order cheque. The bearer cheque implies that it does not require any signature of the payee for the encashment of the cheque, and the bearer of the cheque is entitled to get payment over the counter of the bank. An order cheque, on the other hand, requires the signature of the payee on the back of the cheque for the purpose of its encashment. Although the law of the land does not provide that payment of a bearer cheque is to be made on the procurement of the holder's signature, yet a customary practice has grown up in India according to which the banker demands signature of the payee at the time of encashment of the cheque. But when a stamped receipt is given for the payment, the banker may not insist on the signature of the bearer.

Amount—The fourth formality lies in indicating the amount of the cheque. The amount must be stated clearly both in words and in figures. The amount in words and in figures must agree, otherwise the banker refuses to make payment of the cheque on the ground of discrepancy. The amount in words is deemed more important than the amount in figures. Accordingly, the payment of a cheque with amount written in words only may be made at the option of the banker, but a cheque with the amount mentioned in figures only is never paid by the banker.

Drawer's signature—The signature of the drawer on the cheque

must correspond with the specimen signature supplied to the banker at the time of opening his account. If the signature differs from specimen given to the bank, the payment of the cheque is invariably refused by the banker, because the signature is required to tally with the specimen in respect of both style and finish. The drawer can avoid the trouble of differing signatures through supplying new specimen signatures from time to time, particularly in the case of very old accounts.

Endorsement. Endorsement means the act of writing one's name on the back of a negotiable instrument with the object of transferring its ownership to another. The person who writes his name is called the endorser, and the person to whom the instrument is transferred by endorsement is called the endorsee. The first endorsement on a cheque must be made by the payee of the cheque. In other words, transferor of an order cheque becomes the endorser and the transferee of that cheque becomes the endorsee. There are several kinds of endorsement, such as (1) blank or general endorsement, (2) special endorsement, (3) restrictive endorsement, (4) qualified endorsement, and (5) others.

1. *General endorsement*—A general endorsement is one in which the endorser does not state the name of the person to whom the cheque is transferred, but he merely signs his name at the back of the instrument. It is called blank endorsement because the name of the endorsee remains blank or unfilled. By an endorsement in blank, an order cheque takes the features of a bearer cheque and is capable of being transferred by mere delivery without any endorsement.

2. *Special endorsement*—A special endorsement is a full-fledged endorsement in which the name of the transferee or endorsee is written by the endorser along with his signature. Special endorsement makes the cheque payable to the endorsee or to his order.

3. *Restrictive endorsement*—Restrictive endorsement restricts or prohibits the further transferability of the cheque and the endorsee must make encashment of the cheque. The endorsement on a cheque becomes a restrictive one by adding the word 'only' after the name of the endorsee.

4. *Qualified endorsement*—A qualified endorsement is one in which the endorser wants to be relieved of any liability that may arise from the dishonour or non-payment of the cheque. By adding the words 'without recourse to me' or 'sans recours' after the name of the endorsee, the endorser incurs no liability other than that of a transferor by mere delivery. He exempts himself from the liability for any notarial or other charges.

5. *Other endorsements*—Endorsements may also be partial, facultative or conditional ones. In the case of partial endorsements, the endorser may issue order to pay a part amount out of the full value

of the instrument. By a facultative endorsement, the endorser waives some or all of his rights arising from the dishonour of the instruments, *e.g.* notice of dishonour may be waived. In the case of conditional endorsement, the endorser makes the transference of ownership dependent upon the fulfilment of some stated conditions.

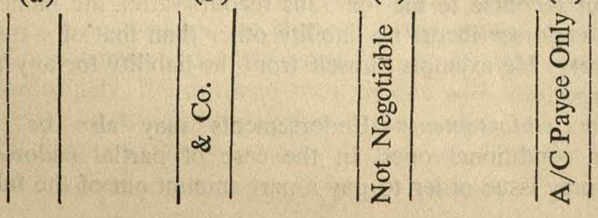
General Rules for Endorsements. The endorsement signature must correspond exactly with the name of the person appearing on the cheque, whether as original payee or as subsequent transferee. Where the endorser makes the endorsement in wrong spelling, the signature of the endorsee should conform first to the inaccuracy and next he may add a second signature with correct spelling. In making the endorsement, the bare name of the endorsee should be written by the endorser ; and all complimentary prefixes and suffixes, whether they are titles of honour or courtesy titles, should be avoided as far as practicable.

A cheque drawn in favour of an unmarried lady, say 'Miss Roy', should be endorsed by her in such a manner as to indicate her full name, *e.g.* Miss Roy may sign as Sita Roy. When the payee of a cheque is a married lady whose name is written in the style of 'Mrs. Roy', the endorsement should be made by the lady through writing her full name. For example, Mrs. Roy may sign as Gita Roy, wife of Sri S. Roy. An illiterate person should endorse a cheque by putting his left-hand thumb-impression which, of course, is to be witnessed by another person. A cheque payable to the joint payees not in partnership should be signed by all the payees unless one of them is specially authorised to operate the account.

Crossing of Cheques. The object of crossing a cheque is to make it payable through another bank. There are two types of crossing : general crossing and special crossing. A cheque is crossed generally when it bears across its face two parallel transverse lines either with or without the words 'And Co.', 'Not Negotiable' etc., between the parallel lines. The drawing of two transverse lines is the essential feature of general crossing. A special crossing, on the other hand, must contain the name of some bank with or without any words or lines. Examples of these two types of crossing are given below :

(General Crossing)

(*a*) (*b*) (*c*) (*d*)



(SPECIAL CROSSING)

(*a*)	(*b*)	(*c*)	(*d*)
The Central Bank	The Central Bank	A/C Payee The Central Bank	The Central Bank Not Negotiable

By the process of crossing, the banker is directed to pay the amount of the cheque to some other bank, and the holder of the cheque is prevented from getting the payment over the counter of the paying banker. In special crossing, the name of the collecting banker is always mentioned, and such bank should place the amount to the credit of its customer after collection. But in the case of general crossing, the cheque can be collected through any bank. The use of the words "Not Negotiable" in any crossing, whether general or special, has a special significance. The essential feature of negotiable instruments, *viz.*, negotiability, is taken away from the instrument, though the cheque is capable of being transferred from one person to another.

Negotiability of an instrument implies that the transferee will get a valid title despite any defect in the title of the transferor. For the acquisition of this better type of title, the transferee is required to obtain the cheque or other instruments in good faith, for valuable consideration, and without any knowledge of the defective title. For example, two cheques are lost or stolen, one with the words 'Not Negotiable' and another without containing such words. The ownership of the thief or finder in regard to the cheques is defective in both the cases, but the cheques can be transferred by the thief to another person. In the case of not negotiable cheque, the thief cannot pass a good title to the transferee who may or may not know the fact of stealing. But in the other case, the transferee will acquire a better title than that of the thief provided the cheque is obtained in good faith. The 'Account Payee' cheque is a sort of direction to the collecting banker to place the amount of the cheque to the credit of the payee only, to the benefit of nobody else. Accordingly, this crossing restricts the transferability of the cheque.

Forged signature and endorsements—Although the bankers are entirely responsible for the forgery of the drawer's signature, they cannot be held liable for the forgery of the endorsement signatures. The bankers cannot be expected to know the signature of all endorsers, and consequently, they are relieved of any liability arising therefrom provided the payment is made in good faith.

Dishonour of Cheques. A cheque is said to be dishonoured when it is not paid by the banker on presentation. Cheques are usually honoured by payment ; but in the following cases, the banker is compelled to return the cheques unpaid. Insufficiency of funds to the credit of the drawer (I/F or R/D), difference between the signature given by the drawer on the cheque and the specimen signature supplied by him to the bank (signature differs), irregularity in endorsements on the cheques, difference between the amounts in words and figures, presentation of a post-dated cheque before the due date, confirmation of a stale cheque, collection of funds against which the cheque has been drawn may not be effected by that time (N/S), and other like circumstances. However, the banker always indicates the reason for dishonour of cheques on a slip of paper, specially printed for the purpose.

Mutilated cheques mean those cheques which are torn into two or more pieces, and such cheques are not honoured by the banker. *Marked* or *certified cheques* are certified by the drawee banker to be within the credit balance of the drawer. In the case of cheques involving heavy amounts and requiring payment on a subsequent date, this marking protects the payee from dishonour caused by the want of funds. Once a cheque is marked by the bank, it becomes the duty of the banker to set apart sufficient funds from the customer's account for the purpose of paying the certified cheque on a subsequent date.

BILLS OF EXCHANGE

"A bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay on demand or at a fixed or determinable future time, a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument." On analysing the above definition of a bill of exchange, it may be found to contain the following requisites : (*a*) it must be in writing ; (*b*) it must contain an order to which no condition should be attached ; (*c*) it must be signed by the person giving the order, *i.e.* the maker or drawer of the bill ; (*d*) it must be drawn upon an ascertainable person ; (*e*) the amount is payable on demand, or at a fixed or determinable future time ; (*f*) it must require payment of a certain sum of money ; and (*g*) it must be made payable to a specified person or to the bearer thereof.

Like the parties to a cheque, there are three parties to a bill ; the drawer, the drawee and the payee. The drawee after acceptance becomes the acceptor of the bill. The bill of exchange may be drawn payable in so many days or months after sight and in so many days or months after date. It may also be drawn to make the bill payable on demand, at sight,

or presentation, etc. Further, a bill may be made payable to order or to bearer. But the two features of 'bearer' and 'demand' cannot be combined so as to make the bill payable to bearer on demand according to the provisions of the Indian Paper Currency Act. The following is a specimen bill of exchange :

Rs. 1,000	Stamp	Calcutta, 15th May, 19 .

Sixty days after sight pay Sri S. K. Banerjee or order the sum of Rupees One Thousand only for value received.

L. R. GUPTA

To

P. R. Patel,
Bombay

Inland and Foreign Bills. As regards the place of drawing and paying bills, they are divided into two classes, *viz.*, inland and foreign. Foreign bills differ from inland bills in four respects. *First,* foreign bills are drawn in sets of two or three identical parts, whereas inland bills have only one part or copy. The object of drawing foreign bills in sets is to protect against the loss of one copy in transit, and thereby to save time. Each copy of the bills is sent to the drawee in a foreign country by different mails so that he can be assured of getting one copy at least. However, one single copy requires stamping. *Secondly,* foreign bills are made payable in so many days after sight, and not in so many days after date like the inland bill. That is, foreign bills require acceptance in all cases. *Thirdly,* foreign bills are liable to a higher rate of stamp duty. Inland bills enjoy a lower rate of stamp duty. Moreover, demand bills drawn within the country are exempted from this stamp duty which is levied on time bills alone. *Fourthly,* noting is compulsory in the case of foreign bills in order to protect the right of action against the parties, but it is optional in the case of inland bills.

Acceptance of Bills. Some of the bills are to be accepted by the drawee, and they are usually known as time bills. But demand bills which are payable on demand, at sight or on presentment do not require any acceptance. To pay at sight or on presentation is equivalent to paying on demand. But bills payable in so many days or months after sight must be accepted, since the period of the bill begins to run from the date of acceptance or sighting. Acceptance may be done by putting

the signature and date of acceptance along with or without the word 'Accepted' across the face of the bill.

An acceptance may be general or qualified. A general acceptance implies an acceptance in toto without any condition or qualification attached to it. When the bill is accepted with modifications as to its terms, that acceptance amounts to a qualified acceptance which may be of five types : (*a*) the payment may be made conditional upon the happening of some events ; (*b*) the bill may be accepted for a part value ; (*c*) the time of payment may be changed ; (*d*) the place of payment may be specified at a particular centre ; and (*e*) the bill may be accepted by some of the drawees only, not by all.

The holder of a bill is entitled to obtain an absolute and unqualified acceptance. Otherwise, he may treat the bill as dishonoured and pursue his remedy consequent upon such dishonour. If the holder agrees to a qualified acceptance without the consent of all the prior parties, he alone becomes responsible for such qualified acceptance and other parties are relieved of the liability.

Due Date and Days of Grace. The time bills that are drawn for so many days after sight or after date become payable on the expiry of three extra days. These three extra days are known as grace days which are not allowed in the case of demand bills. If the last day of grace is a Sunday or a public holiday, the bill is due and payable on the previous working day. When the last two days of grace happen to be Bank holidays, the bill is due and payable on the succeeding business day. The tenure of the bill may be of varying lengths in the case of inland bills ; but the tenure of foreign bills is more or less fixed and is known as usance. Usance is the customary length of time prevailing between two countries for the purpose of drawing bills.

Negotiation of Bills. A bill is negotiated when it is properly transferred from one person to another. A bill payable to bearer is transferred by delivery and a bill payable to order is transferred by endorsement as well as by delivery. An endorsement on a bill may be one of the following types : (*a*) blank endorsement requires the simple signature of the endorser on the back of the bill ; (*b*) a special endorsement specifies the name of the person to whom or to whose order the payment is to be made ; (*c*) a restrictive endorsement prohibits the negotiability of the bill ; (*d*) a qualified endorsement exempts the endorser from any liability other than that of a transferor by delivery, *e.g.*, 'sans recours' or 'without recourse to me' ; and (*e*) facultative endorsement waives the rights of the endorser, *e.g.* 'notice of dishonour waived.' Partial endorsement is not operative for the negotiation of a bill. When a bill is required to be endorsed by many persons, an additional slip of

paper known as "*allonge*" is attached to the bill at its bottom. The latter signatures are to be given partly on the bill and partly on the allonge.

Holder in due course—The person to whom the bill is negotiated becomes the payee or holder of the bill. A holder in due course means a holder who receives the bill (*a*) before its due date or before receiving notice of dishonour, (*b*) for valuable consideration, and (*c*) without any knowledge of its defective titles, *i.e.* in good faith.

Accommodation Bills. An accommodation bill (or kite) is drawn and accepted without giving or receiving any value in exchange for it. It is a method of raising bank loans by offering fictitious bills as security for loans. However, the accommodation bill appears exactly like a genuine trade bill. When the bankers can detect these false bills, they refuse to discount accommodation bills which do not arise from business transactions.

Dishonour of Bills. A bill is said to be dishonoured by non-acceptance or non-payment when the acceptance or payment of the bill is refused by the drawee on its proper presentation. When a bill is dishonoured, the present holder is required to give a formal notice of dishonour to all parties whom he wants to make liable for the amount ; and in default of notice, the holder loses his right of action against the prior parties. Each holder has a right of action against his previous holders and in this way the dishonoured bills find their way back to the original drawer ultimately. The drawer of the bill takes up the matter with the acceptor, and claims of other parties are satisfied by the drawer.

Noting and protest—With a view to obtaining a formal proof of dishonour, the bills are usually required to be noted and protested by a notary public. Protest is necessary in the case of all foreign bills, while the inland bills do not usually require this protest. The notary notes the particulars of dishonour in his register after presenting the bill for the second time and ascertaining the facts of its subsequent dishonour. From the particulars the notary issues a formal written protest which is accepted in all courts. The protest is a formal certificate attesting the dishonour.

Acceptance and Payment for Honour. The drawer of a bill or an endorser is entitled to insert in the bill the name and address of an outside person who may be referred to in the event of dishonour. That outside person may either accept the bill or pay the bill for the honour of any party liable thereon. In both the cases, however, the bills must be protested first and then acceptance for honour or payment for honour may be done. By the payment of the bill for honour, the outsider takes the rights of that party for whose honour he pays.

PROMISSORY NOTES

A promissory note is "an unconditional promise made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer". This note is made by the debtor in favour of his creditor, and it contains an unconditional promise to pay the amount usually on the expiry of a fixed period. There are only two parties, *viz.* the maker and the payee. The maker is the debtor while the payee is the creditor.

When a promissory note is made by two or more persons, the makers can render themselves either jointly or jointly and severally liable on the note. In the case of joint liability, only one right of action lies against the makers, whether all of them are included or not. But in the case of joint and several liability, one or more actions can be brought against the makers individually or jointly.

The instrument called IOU (I owe you) is neither a promissory note nor a negotiable instrument, not even a receipt. It is merely written evidence of a debt between two parties and does not require to be stamped. Promissory notes are negotiable instruments, and they are to be stamped with an *ad valorem* duty which is six paise up to Rs. 250, twelve paise up to Rs. 1,000 and twenty-five paise for any amount thereafter. But in contrast to the bills of exchange, promissory notes are much inferior types of instruments. *In the first place,* promissory notes are one-name commercial papers as compared to bills which are two-name papers. *Secondly,* promissory notes are not discounted by the commercial bank so that they may be of any help in raising bank credit. *Thirdly,* promissory notes are not widely transferable like the bills.

Promissory notes differ from bills in the following respects : (*a*) They contain promise to pay, not an order to pay. (*b*) They involve two parties and the makers are the principal debtors ; but bills involve three parties of whom the drawer undertakes a secondary liability and the acceptor assumes the primary liability. (*c*) Notes are never accepted, whereas time bills require acceptance. (*d*) Makers of a note may be jointly or severally liable, but the acceptors of a bill are always jointly liable. (*e*) Notes are issued by a debtor in favour of a creditor, while bills are drawn by a creditor upon his debtor. (*f*) The stamp duty is different in the two cases.

HUNDIS

Hundis are the Indian counterparts of the common bills of exchange. The hundis are widely used by shroffs and bazar traders for carrying out their lending transactions. The local usages and prac-

tices generally regulate the issue and payment of these hundis. When the practices do not cover a particular case, the provisions of the negotiable instrument law govern the case. Like bills of exchange, hundis may be payable either on demand or after sight. Demand hundis are known as '*Darshani Hundis*' and time hundis are called '*Muddati Hundis*'. *Dhani Jog Hundi* is payable at a "*dhani*", *i.e.* place. *Farman Jog Hundi* is payable according to "*farman*", *i.e.* order. Some common hundis may be stated as follows :

Shah Jog Hundi—As the name 'Shah' implies respectability, this hundi is drawn by a respectable person upon another respectable person in the financial circle. It is made payable after a certain period and no formal acceptance is required on the part of the drawee who only records the important particulars in his books. It passes from hand to hand by mere delivery until its encashment by the last holder who is required to give his signature as an evidence of payment. When the holder of a hundi is willing to receive payment, he must present the hundi to the drawee before due date so that the drawee can ascertain the respectability of holder and send the amount of hundi to the office of the holder on due date.

Jakhmi Hundi—The Jakhmi Hundi is a device by which the safe arrival of the goods to the buyer is ensured through an advance payment by a *hundiwala*. This hundi is drawn by the shipper of the goods upon the *malwala, i.e.*, the consignee of the goods. But as the drawee is not held liable for the goods before their arrival, jakhmi hundi is issued against the credit of the drawer only, and not on the credit of the drawee. The drawee may not have any dealing at all with the hundi. The drawer after drawing the hundi sells it to a hundiwala who is an underwriter for the transhipment of goods as well as a dealer in hundis. The hundiwala pays the amount of the hundi to the drawer beforehand and recovers the amount from the drawee subsequently when the goods reach safely.

Nam Jog Hundi—The hundi is made payable to a definite person or to his order. Because the name of the payee is given on this hundi, it is called *Nam Jog Hundi*. In contrast to the bearer hundi, it is an order hundi which can be transferred by delivery and endorsement. But when it contains a description of the party instead of his actual name, the transference of the hundi is stopped.

Jawabee Hundi—A person desiring to remit money writes a letter to the payee and delivers the letter to a banker for its onward transmission to an agent banker near the payee's place of residence. On its arrival the letter is forwarded to the payee with a request to collect the amount from the agent banker. In receiving the amount, the payee is required to give a receipt in the from of an answer (or *jawab*) to the

letter. The jawab is an essential part of the transaction and is sent back to the remitter through the same channel.

Zickri Chit—It is a letter of protection in which an alternative drawee is mentioned, in case the hundi is dishonoured by the original drawee. It is addressed by the drawer to a person residing at the place where the hundi is payable with the request for taking up or honouring the hundi, if necessary. This *Zickri Chit* accompanies the hundi and the holder of the hundi can realize the amount from the person named in the chit.

OTHER CREDIT INSTRUMENTS

Trade draft—Before the bill is accepted by a drawee, it is known as a 'draft' ; and after the acceptance of the draft, it becomes a trade acceptance that moves freely in banking circles. Since all bills do not require acceptance, some of them may be regarded as drafts and others as acceptances. The demand bills are popularly known as "*sight drafts*". But drafts have very little value in exchange, because the debtor may not pay it. However, drafts are useful in connection with sale of goods on the basis of *cash on delivery* (*C.O.D.*) terms. Bills of lading or railway receipts along with the drafts are forwarded to a bank in the buyer's locality. In order to obtain the goods, the buyer must secure the documents of title from the bank after making payment for the draft. The shipping documents may also be made deliverable upon acceptance of the draft for paying at a future date.

Bank drafts—In contrast to the trade draft, bank drafts are often used for the purpose of transferring funds from one place to another within a country or from one country to another. A bank draft is an order given by one bank upon its another branch-bank or agent-bank situated elsewhere to pay a certain sum of money. The person desiring the draft purchases it from the issuing bank and sends it to the payee who secures the money from the paying banker. Remittances through bank drafts are far cheaper than sending money by postal money-order or by postal insured cover. Besides bank drafts, commercial banks arrange for the remittance of funds by way of telegraphic transfer. With the help of telegraphic message, funds can be transferred very quickly from one place to another on the similar line that is adopted in the case of postal *telegraphic money order* (T.M.O.).

CHAPTER 20

STOCK EXCHANGES

NATURE OF STOCK EXCHANGE

The stock exchange is an indispensable institution for the smooth functioning and steady growth of the corporate form of business enterprises. It supplies the sinews of industry by way of providing the investors with an opportunity to shift their investments whenever they desire. As an organized market for existing securities, the stock exchange underpins the capital market for supplying increased amount of capital to business. In the absence of this facility for shifting investments, capital accumulations would have been much lower than what they are today. No matter how the original sale of new securities is effected, the continued carrying of securities for generations together has been made possible through the operation of the stock exchange. The mechanism of the stock exchange is utilized not only for shifting industrial securities, but also for securities issued by Government, Semi-Government or local authorities.

In the matter of raising capital too, the stock exchange is of considerable importance. It forms the nucleus around which the different components of the financial market rotate and get nourishment. Because of its permeating influence on the whole economy, it acts as the citadel of capital and the pivot of the money market. It forecasts the financial climate and regulates the investment psychology. All events and issues that have direct or remote influence on the profitable working of corporate enterprises are immediately mirrored into the operation of stock exchanges. As a result, the stock exchange becomes the barometer of industrial conditions reflecting the current position, the future outlook and the background situations of the business world.

Functions and Services. The functions and services of the stock exchange may be stated as follows :

1. The stock exchange provides a ready and continuous market where the securities can be bought or sold by investors as they please. Because of this ready and continuous market, the stock exchange facilitates the prompt shifting of investments at any time with a comparatively greater stability in security prices.

2. Through an excellent arrangement for communication, the stock exchange integrates the demand for and supply of securities in an effec-

tive manner and crystallizes the value of investments every now and then. The resultant price that emerges from the interaction of countless bids and offers in the transaction of securities provides the investor with a means of securing corporate information and of verifying the real value of his security holdings.

3. Since transactions are made publicly under well-defined rules, regulations and bye-laws of the exchange, it ensures a greater measure of safety and fair dealing to the average investors than what they could expect elsewhere.

4. It directs the flow of capital into the most profitable channel, and thereby secures an effective utilization of investible funds for the social good. This flow of capital is caused by the prices established in the market for individual securities and by their relative yields.

5. It stimulates industrial investments as distinguished from other unproductive investments in lands, bullion, etc. This mobilization of funds towards investments in corporate securities results in fostering industrial growth and economic development of the country.

6. It provides an incentive to the community at large to make savings for investment purposes. The fortunate combination of yield factors with the liquidity facility of investments paves the way towards larger capital formation and greater prosperity of the nation.

7. The stock exchange through the constant publicity of security prices induces the corporate enterprises to raise their standards of performance. Both at the time of enlisting new securities on the exchange as well as in subsequent years of existence, the stock exchange appraises the activities of business concerns and thereby urges their betterment. Also, it provides an indirect check against bad running of their affairs.

Briefly, community savings, productive investments, capital formation, industrial growth, economic development and individual prosperity are the integrated chain of benefits that may be derived from the efficient working of stock exchanges in a country. To summarise the services of a well-organized stock market in the words of Sri C. D. Deshmukh, "The economic services which a well-constituted and efficiently run securities market can render to a country with a large private sector, operating under the normal incentives, and impulses of private enterprise are considerable. *In the first place,* it is only an organized securities market which can provide sufficient marketability and price continuity for shares so necessary for the needs of investors. *Secondly,* it is only such a market that can provide a reasonable measure of safety and fair dealing in the buying and selling of securities. *Thirdly,* through the interplay of demand for and supply of securities, a properly organized stock exchange assists in a reasonably correct evaluation of securities in terms of their real worth. *Lastly,* through such evaluation of securities, the

stock exchange helps in the orderly flow of distribution of savings, as between different types of competitive investments."[1]

Importance of Security Listing. Trade in securities takes place in two different ways : (*a*) over-the-counter dealings, and (*b*) trading on stock exchanges. Trading on organized exchanges is confined to listed securities while over-the-counter market deals in unlisted securities. Non-industrial securities issued by the Government or local authorities are the main group of unlisted securities. Besides, there are many industrial securities issued by the small companies and such securities are not listed on any exchange. Transactions in unlisted securities are effected by stock brokers and other dealers in securities outside the organized exchanges. In the case of Government securities, transactions involve so heavy amounts with certain peculiar characteristics, and in the case of small company's securities, transactions are so casual and few in numbers that they are not suitable for trading on the floor of stock exchanges. Unlisted securities, whether Government or industrial, are transacted through private negotiations by the firms of stock and share brokers. For the marketing of Government securities, there are thirty special brokers associated with the Reserve Bank of India and they handle the bulk of the business. In contrast to negotiated sale in the case of unlisted securities, transactions in listed securities are made through an auction method of sales on organized stock exchanges.

Usually, securities of large-sized companies are required to be listed on a stock exchange for the purpose of their trading in that market. Unless the securities are approved for listing, the trading permission is not granted to such securities. Both the company and the investors are benefited by listing of securities. The company enjoys the confidence of the investing public and is assured of their support in raising capital for the reason of imparting a wider marketability to securities through such listing. Listing carries the hall-mark of prestige and confers on the listed company the benefits of broader publicity, greater respectability and larger tax relief. From the standpoint of investors, listing not only provides a ready market for securities, but also a number of protective services are extended. Since a searching analysis is made about the capital structure, management pattern and business prospects of the company at the time of admitting securities for dealing on the exchange, and since certain minimum standards of performance are enforced throughout the period of company's operations, listing results in assuring investors as to the genuineness of securities. But listing does not amount to guaranteeing the financial solvency or the profitability of a company.

[1] Speech for introducing the Securities Contracts (Regulation) Bill before the Parliament.

For the benefit of investors, listing implies that there is an existence of good faith or an absence of fraud in regard to the issue of securities. Listing provides a privileged position to the shareholders by imparting a higher collateral value to securities, allowing them to enjoy some tax concessions and providing the facilities of quick transfer, registration and corporate information.

Listing permission is granted to companies on their fulfilment of certain conditions as well as on their furnishing some detailed information to the stock exchange authorities. Some of the important listing requirements that are insisted upon by the exchange authorities in India at the present time include (*i*) an equitable and proportionate distribution of voting rights and dividend rights over different classes of shares, (*ii*) a public offer and issue of share capital to a minimum extent of 49 per cent, (*iii*) an obligation towards informing the exchange authorities about the details of dividend distribution immediately after the board meeting, and (*iv*) an undertaking as to secure compliance with the provisions of the Companies Act and the Securities Contracts (Regulation) Act as well as the rules made thereunder. The Central Government has assumed the power to compel any public limited company to get its securities listed on an organized exchange.

ORGANIZATION OF STOCK EXCHANGES

Constitution. The Securities Contracts (Regulation) Act, 1956, which has come into force from February 20, 1957, permits only recognized stock exchanges to operate in the country. The Central Government reorganized five exchanges in the year 1957, two exchanges in 1958 and one exchange in 1963, namely, (*a*) the Bombay Stock Exchange from August 31, 1957 (renamed from the Native Share and Stock Brokers' Association), (*b*) the Ahmedabad Share and Stock Brokers' Association, from September 16, 1957, (*c*) the Calcutta Stock Exchange Association Ltd., from October 10, 1957, (*d*) the Madras Stock Exchange, from October 15, 1957, (*e*) the Delhi Stock Exchange Association Ltd., from December 9, 1957, (*f*) the Hyderabad Stock Exchange Ltd., from September 29, 1958, (*g*) the Indore Share Brokers' Association, from December 24, 1958, and (*h*) the Bangalore Stock Exchange, from February 16, 1963. Of these eight exchanges, recognition to the Bombay Exchange has been granted on a permanent basis and that in the case of others for a period of five years in the first instance.

During the nineteenth century, the Bombay and Ahmedabad Exchanges came into existence ; while all others were established in the present century. On the model of the London Stock Exchange, both the Bombay and Ahmedabad Exchanges were organized as voluntary, non-

profit making associations in 1875 and 1894 respectively. The Calcutta Exchange was established in 1908 as an unincorporated association and became incorporated as a company limited by shares in 1923. Of the exchanges appearing later on, the Madras (1923) and Delhi (1947) Exchanges were formed as public limited companies in which the liability of members was made limited by shares. The Hyderabad Exchange, being established in 1943, was organized as a company limited by guarantee. Being originally established as a company limited by shares, the Madras Stock Exchange was reorganized as a guarantee company in 1958. The Indore Exchange which emerged in 1930 was set up as a private club, as distinguished from incorporated companies and organized voluntary associations. The Bangalore Stock Exchange, being established in 1957, was incorporated as a private limited company in the year 1962. At the time of granting recognition, although the basic nature of incorporated or unincorporated associations has been retained unaltered, a levelling influence is to be witnessed in matters of rules, regulations and bye-laws of different exchanges. As rules and regulations of exchanges require the prior approval of the Central Government for recognition purposes, various exchanges after the enforcement of the Securities Contracts (Regulation) Act display a uniformity in their organizational pattern.

As recognition is refused to more than one exchange in a particular centre, five exchanges were denied recognition and they went out of existence after 1957. These defunct exchanges include (*a*) the Bombay Share and Stock Brokers' Association, (*b*) the Indian Stock Exchange, Bombay, (*c*) the Bengal Share and Stock Brokers' Association, Calcutta, (*d*) the Gujarat Share and Stock Exchange, and (*e*) the Indian Share and General Exchange Association, Ahmedabad. This abolition of additional exchanges in different centres has assisted in the prevention of kerb trading, since such trading has been declared illegal under the provisions of the Securities Contracts (Regulation) Act. In other words, gambling dens have been sealed through the refusal of recognition to such exchanges.

The relative size and importance of various exchanges can be indicated from the number of listed companies and listed securities on the recognized exchanges. At the end of December, 1972, the listed companies numbered 629 at the Calcutta Stock Exchange, 614 at Bombay, 356 at Madras, 215 at Delhi, 131 at Ahmedabad, 73 at Bangalore, 41 at Hyderabad and 17 at Indore. At the end of December 1972, there were 1,133 listed securities on the Bombay Stock Exchange, 1,063 on the Calcutta Exchange, 666 on the Madras Exchange, 400 on the Delhi Exchange, 271 on the Ahmedabad Exchange, 118 on the Bangalore Exchange, 75 on the Hyderabad Exchange and 26 on the Indore Exchange. Corresponding to the growth of companies, how-

ever, new stocks are being added every year to the list of securities on all exchanges. In addition to cash trading, forward trading is permitted by all exchanges in those securities which are placed on the forward list. The number of securities on the forward list as on December 31, 1971 stood at 67 in Bombay, 19 in Calcutta, 15 in Madras, 11 in Ahmedabad, and 7 in Delhi. The securities dealt in on different exchanges reflect the locational pattern of industries in the country. For example, shares of cotton mills and banking companies predominate in the Bombay market ; jute, tea, bank and engineering shares in Calcutta ; plantation and textiles in Madras ; and textiles in Ahmedabad. Out of 1622 listed companies, one was listed on 6 exchanges, one on 5 exchanges, 14 on 4 exchanges, 63 on three exchanges, 269 on two exchanges and the rest on only one exchange.

Management. Each stock exchange is managed by an executive committee, the composition and powers of which vary from exchange to exchange. Since the enforcement of the Act, all executive committees are to be constituted by the inclusion of Government nominees up to a maximum of three members. The executive committee which is entrusted with the responsibility of overall control and guidance has been called by various names in different markets. On the Bombay Exchange, it is called the "Governing Board," on Calcutta the mere "Committee", and on other exchanges, it goes by the name of the "Council of Management". The Committee for management in Calcutta is composed of 19 members, of whom one is elected as the President of the Association as well as the Chairman of the Committee. A number of sub-committees are organized for supervising the day-to-day operations of stock exchanges. Some important sub-committees are the Listing Committee, the Defaulters' Committee, the Arbitration Committee, and the like of them.

The London Stock Exchange having supplied the model for organizing various exchanges in our country, it would be appropriate to enquire about the pattern of management prevailing in that market. Before June 1945, there was a system of dual control over the London Exchange ;(*a*) the Committee for General Purpose was in charge of controlling business and of framing necessary rules and regulations therefor, and (*b*) the Trustees and Managers dealt with finance and market place. Since June 1945, these two bodies have been fused into the Council of the Stock Exchange for exercising effective and unitary control over the activities of the London Stock Exchange. As required by the large volume of business transacted on that exchange, the Council of the Stock Exchange has been split into twelve sub-committees for discharging responsibilities in different areas of the management work.

Membership. It is the members who alone are entitled to transact business on a stock exchange. Consequently, membership rights bestow a privileged position upon the members of an exchange. For acquiring this membership right, there are varying restrictions and different practices on the part of different exchanges. To become a member of any exchange in India, an individual has to pay entrance fees, membership deposits and annual subscriptions in addition to the acquisition value of one share or one membership card in some cases. The amount of these different fees and charges has now been fixed by the Government in consultation with the individual exchanges. As regards membership deposits, the amount has been fixed at Rs. 20,000 for Bombay and Calcutta Exchanges, Rs. 5,000 for Madras, Ahmedabad and Bangalore Exchanges, and Rs. 3,000 for Hyderabad and Indore Exchanges. As regards entrance fees, the amount stands at Rs. 1,100 in the case of Calcutta, Rs. 2,500 in Madras, Rs. 2,571 in Hyderabad, Rs. 1,601 in Ahmedabad, Rs. 1,100 in Indore and Rs. 500 in Delhi. In addition, the price of each share comes to Rs. 7,000 in the case of Calcutta, about Rs. 6,000 in Delhi and Rs. 1,800 in Ahmedabad. For the Bombay Exchange, there is one aggregate card value amounting to Rs. 17,000 without any separate charge for entrance fees or share value. To summarise the membership cost barring the small amount of annual subscriptions, it comes to Rs. 37,000 on the Bombay Exchange, Rs. 28,100 on the Calcutta Exchange, Rs. 7,500 on the Madras Exchange, Rs. 6,500 on the Delhi Exchange, Rs. 8,401 on the Ahmedabad Exchange, Rs. 5,571 on the Hyderabad Exchange and Rs. 4,100 on the Indore Exchange.

Membership seats are strictly limited. Unless one seat falls vacant, an outsider cannot become a member through the acquisition of one share or one card, as the case may be. On March 31, 1962, the number of members was 501 in Bombay, 1,112 in Calcutta, 409 in Ahmedabad, 35 in Madras, 106 in Delhi, 57 in Hyderabad, 72 in Indore and 10 in Bangalore. Membership has been confined to individual members after the enforcement of the Act, and the firms of stock brokers have been prevented from becoming members of an exchange. However, for trading purposes, formation of partnerships is permitted. To enable the partners of such dissolved firms to become members of the exchange, membership seats of the Calcutta Exchange have been increased to a maximum level of 1,200 by splitting each share of Rs. 1,000 into four equal parts. Furthermore, the members of the unrecognized exchanges have been admitted to the benefits of trading on recognized stock exchanges through the expansion of their membership seats.

Authorised clerks and remisiers—To assist the members for making transactions on the exchange as well as for securing business from the outsiders, members are permitted to appoint a fixed number of authorised

clerks and remisiers. The number of authorised clerks varies from one exchange to another. The Bombay Exchange, following the practice of the London Exchange, permits five authorised clerks on the part of every member while the Calcutta Exchange now permits two clerks, and the Madras Exchange three clerks, or member assistants as they are alternatively called in that market. Authorised clerks are mere employees of the members and transact business on behalf of their employers. They are not allowed to make transactions on the exchange in their own names. Besides the salary, the authorised clerks get a commission up to 50 per cent of such brokerage as may be earned from transactions with non-members. Despite this commission and salary, the total remuneration of authorised clerks is very meagre, and as such they are tempted to make secret bargains on their own account. The London Stock Exchange places the authorised clerks in a favourable position by reserving a certain percentage of exchange membership for their benefit and by allowing them concessional rates in regard to entrance fees and subscription fees. Clerks with four years' service on the exchange or in the settling room qualify for membership of the London Exchange. In contrast, even the life-long service is of no consideration in our country for admitting authorised clerks to exchange membership, and they are not allowed any concessions in matters of entrance fees, membership deposits, etc.

Since members are debarred from making advertisements or issuing public circulars for the purpose of procuring business, they require the assistance of remisiers for securing regular clientele. Remisiers are mere agents appointed by the members. Since members of the stock exchange act very often in the capacity of brokers, remisiers engaged by such member-brokers are referred to as sub-brokers. Also, remisiers are known as half-commission men because they receive a commission, not exceeding 50 per cent, on the business canvassed by them. Being the procurer of business only, remisiers are not allowed to make transactions on the exchange either on their own account or on behalf of the member appointing them. Only when they are given the status of authorised clerks, remisiers can enter the trading ring and transact business on behalf of the member. Following the practice of the Bombay Exchange, appointment of remisiers has become common nowadays with all exchanges. However, stock exchanges have an obligation to maintain a register of authorised clerks and remisiers for the information of all concerned.

Jobbers & Brokers on the London Exchange. The membership list of the London Stock Exchange is divided into two classes, brokers and jobbers. Every member has to declare at the beginning of each year whether he proposes to act either as a broker or a jobber, and the divi-

sion runs through for the whole year. The classification becomes a rigid one, and a member is not allowed to act in both capacities at the same time. The jobber is a dealer in securities on his own account and has no direct contact with the general public. The jobber's business of buying and selling securities is only to be made with the other members who are acting as brokers, and the difference between the purchase and selling prices of securities constitutes his income. The broker, on the other hand, is a commission agent and acts for the investing public. He is the intermediary between the jobber and the outside investor.

Jobbers occupy a pivotal position in the London Stock Market and constitute the core and centre of the market, since every transaction must pass through their hands. Whenever the brokers intend to enter into a transaction with them, the jobbers invariably quote two prices, the lower being the purchase price and the higher is looked upon as the selling price. As the jobbers are always ready to buy and sell any number of shares, they are not interested to know whether the brokers want to buy or sell securities. If the brokers are satisfied with the jobbers' quotation, they disclose the nature of their transactions and strike necessary bargains. This double quotation, or the *"double-barrelled price"* as it is called, represents the bargaining limits and ensures a fair deal to the investing public. The system of jobbers acts as a barrier against violent price fluctuations and enables the outside investors to complete their transactions quickly and smoothly. The system appears to be indispensable for the London Stock Market which has about 10,000 securities on its trading list. The system has introduced the principle of specialization in the dealing of such a vast number of securities which are divided into twenty-one distinct groups. It provides also a comparatively cheap method of security dealing; the jobbers are accustomed to taking the difference between buying and selling prices as their only remuneration which is known as *"jobbers' turn."*

Taravaniwalas & Brokers on the Bombay Exchange. On the analogy of the London market, the members of the Bombay Stock Exchange have unofficially divided themselves as *taravaniwalas* and commission brokers. The *taravaniwalas* are supposed to act as dealers like the jobbers, and the commission brokers are to act on behalf of the outside investors. But the resemblance is a superficial one rather than real; and there is a great difference between the two systems. The necessity of such specialization in activities does not arise in the case of the Bombay market because of the small volume of transactions. The members cannot keep themselves busy through working in the capacity of either brokers or dealers. Consequently, the *taravaniwalas* find no alternative but to encroach upon the activities of brokers. The division

of members is not made into water-tight compartments, and there is much overlapping in regard to the activities of members. The *taravaniwalas* change their role frequently with the object of making as much profit as possible at the cost of other parties. This change of role is facilitated owing to the absence of double quotation on the part of *taravaniwalas* and the prevalence of voidable nature of contracts. The *taravaniwalas* frequently make false offers or false bids and back out of the transactions that appear unfavourable to them. This practice is open to serious abuses. And the *taravaniwalas* have not missed the opportunity of exploiting the market always to their best advantage. They dispose of their own holdings to the outsiders at inflated prices ; they keep the securities for themselves when the buying bargains for outsiders are made at lower prices ; and they manipulate the price of securities against the broker-members who fail to execute their clients' transactions. As a remedy for the situation, it was suggested by Dr. Thomas as well as by the Gorwala Committee that members should be prohibited from trading with their clients as principals, and that the practice of making false transaction and subsequent compromise should be stopped by defining their business properly. The new Securities Contracts (Regulation) Act has provided for these ameliorating measures.

METHODS OF TRADING

The methods of trading are generally determined by the nature of transactions. Transactions are made either for the purpose of investment or for speculation. The investment transactions require the actual delivery of securities on the part of sellers and the payment of their full price by the buyers. On the other hand, the speculative transactions are made by the parties who do not want to pay for and take delivery of the securities that they have contracted to transfer. Such transactions are usually reversed by the offsetting sale and purchase of securities ; the price difference is pocketed by one party and suffered by the other party. As the speculative transactions do not call for the payment of the full price but can be made by the deposit of a fractional part of the price, the volume of speculative transactions becomes much higher than that of the investment transactions on any stock exchange.

The stock exchange transactions are made by two methods of trading, *viz.*, ready delivery contracts and forward delivery contracts. Alternatively, these methods of trading are called cash trading or cash transactions and forward trading or dealings for the account. Only three of the exchanges are organized for trading under the method of ready delivery contracts, and all other exchanges are established for trading on the basis of both ready delivery and forward delivery contracts. The Hyderabad Stock Exchange, the Indore Stock Exchange and the Banga-

lore Stock Exchange have been established for trading on the basis of ready delivery contracts and these stock exchanges are known as cash markets. The Bombay Stock Exchange, the Madras Stock Exchange, the Calcutta Stock Exchange, the Ahmedabad Exchange and the Delhi Exchange permit both ready delivery contracts and forward delivery contracts. The ready delivery contracts are referred to as "cash transactions" and the resultant confusion arises as to the nature of such transactions ; they are presumed to be investment transactions only and the forward contracts alone are deemed speculative transactions. It should be clearly understood that speculative transactions are associated with the case of both ready delivery contracts and forward delivery contracts. Speculation is the mainstay of stock exchange operations, and the mere investment transactions cannot provide sufficient volume of business so as to make the stock exchange a ready and continuous market.

Ready delivery contracts differ from forward delivery contracts in three important respects. *In the first place,* ready delivery contracts are to be settled either on the same date or within a short period that may extend at best up to seven days. When these bargains are to be fulfilled on the very date of the contract or on the next day, they are spoken of as spot contracts. In contrast to these contracts, forward delivery contracts are discharged on fixed settlement days occurring at fortnightly intervals. *Secondly,* ready delivery contracts must be settled within the specified limit and they cannot be carried over to an extended period, But forward delivery contracts enjoy the facility of carry-over and such bargains can be completed in the next settlement period. *Thirdly,* ready delivery contracts can be made in respect of all securities, whereas forward delivery contracts remain confined to those securities which are placed on the forward list.

Both these two types of contracts are made by the members of the stock exchange acting as brokers on behalf of the outside dealers. But on the Bombay Stock Exchange, the *taravaniwalas* enter into contracts as principals for their own benefit. In other markets also, the members make bargains on their own accounts. Hence, according to the prevailing practice of our stock exchanges, contracts are made by members working in the capacity of principals or brokers. But before the enforcement of the Securities Contracts (Regulation) Act, there were two serious defects in the making of contracts. First, it was not necessary for the members to disclose the capacity in which they were making bargains, and consequently, they could change their role at any time for the purpose of satisfying their personal interest. Secondly, as transactions were always made between two members of the exchange, the outside dealers could not verify the price of securities at which transactions were made on the floor of the exchange unless the original contracts between members were submitted to them for inspection. In

the past, the member-brokers used to make separate contracts with the outside dealers and there was no necessity of showing the original contracts to them. However, these defects are going to be remedied by the new Act. Under the existing rules, when a member buys or sells for his own account, he has to give a separate contract note as opposed to the one that he is required to give in the case of acting as a broker.

Clients' Orders and Their Execution. As transactions on the exchange are confined to members and their authorized clerks, outsiders are to place orders to buy or sell securities with a member who acts in that case as a broker for the outside parties. Outsiders' orders can be classified into the following seven types—(*i*) fixed price orders, (*ii*) limit price orders, (*iii*) bargain price orders (market or best price orders), (*iv*) immediate or cancel orders, (*v*) stop-loss orders, (*vi*) discretionary orders, and (*vii*) open orders. The *fixed price order* specifies the price at which securities are to be bought or sold by the broker. Subject to this specified price, orders may be executed at such prices as appear favourable to the clients. For example, an order to buy 10 Indian Iron ordinary at 22 has to be executed at Rs. 22 per share or below the amount. *Limit price orders* are intended to provide a greater latitude to the brokers by indicating the upper or lower limit of prices. Limit price orders like "buy under 23" or "sell over 21" enable the broker to go through the transaction promptly and certainly, while the fixed price may remain unexecuted for a long period. In the *bargain price orders,* a wider latitude is given to the broker for completing the transaction at the best obtainable price ruling in the market. To illustrate, an order to "buy 10 Indian Iron ordinary at best" does not limit the price in any way. At the time of fluctuating prices, fixed price orders are usually circumscribed by *immediate* or *cancel orders.* An order to "buy (or sell) at 22 immediate or cancel" implies that the order is to be executed immediately at desired prices or other favourable prices, and if it is not possible, the order stands cancelled. *Stop-loss orders,* as their name implies, are issued to limit the amount of loss on the previous purchase or sale of securities by indicating the stopping point in price movements. The loss arising from a prior sale at 20 may be limited to Rs. 2 per share by giving an order to "buy at 22 stop". Whenever the price touches 22, the broker is instructed to stop further and to buy the share immediately at 22 or at the best price available. Conversely, buying securities at 22, an order to "sell at 20 stop" may be issued for limiting the loss at Rs. 2/- per share. As soon as the price comes down to 20, the broker must sell the securities without further waiting. *Discretionary orders* are placed by investors who have full reliance upon the broker for purchasing some comparatively inactive securities. Like the bargain orders, a good latitude is given to the broker

as regards prices. *Open orders* are kept in operation so long as they are not cancelled. Unlike other orders which are to be executed within a specified time, say a week or a fortnight, open orders remain valid until they are cancelled.

On receiving the order from a client, the broker or his authorized clerk goes to the trading post or wing reserved for the particular scrip for making necessary bargains. Members quote offer and bid prices by the call method which amounts to shouting or openly declaring their individual prices. When the bid price equals the offering price, bargains are closed and necessary particulars as to the number of securities, the price agreed upon, the name of the other party and his membership number are noted down on a small pad. Transactions are always made in terms of that unit of trading which is fixed by a certain minimum number of shares in respect of that security. After the close of official hours, all bargains of the day are entered into the Cash Transaction Book or the Forward Delivery Transaction Book, as the case may be, with all relevant details including fees and brokerage charges thereof. On the basis of this record, Contract Notes are prepared by the members and verified on the next day by the other party who is to sign such notes for the purpose of authentication. Finally, the notes are sent to their clients by both the members of the exchange.

Settlement of Ready Delivery Contracts. When an outside dealer is willing to make contracts, he must approach a member of the stock exchange. As a guarantee for fulfilling the terms of contracts to be made for outside dealers, the members of the exchange usually demand a certain percentage of the price as covering money or a suitable bank reference from their clients. After being satisfied with the credit-standing of the parties, members make contracts for delivery of securities and their payment within the specified period of the exchange. This period usually varies from one day to seven days. In the case of the Bombay and Madras Exchanges, a period of seven days is allowed for settlement, whereas on the Calcutta Exchange the ready delivery contracts are settled within three days. The actual settlement is done in two different ways, *viz.*, (*a*) by taking (giving) delivery of the security and making (receiving) full payment of its price, and (*b*) by squaring up the transaction through a neutralising sale or purchase of securities at the time of settlement so that only the price difference is to be adjusted between the two members. The settlement procedure differs according to the nature of securities. For this purpose, securities are divided into two classes—cleared and non-cleared securities. The transactions in cleared securities are settled through the medium of the stock exchange clearing house, while the transactions in non-cleared securities are settled by hand delivery with or without the knowledge

of the stock exchange authorities. The actively traded securities are only cleared through the clearing house and the other securities are cleared by hand delivery. Such clearing houses have been arranged by five exchanges of the country. The clearing houses of the Bombay and Madras Exchanges are managed by the Bank of India, that of the Calcutta Exchange by the Allahabad Bank, and that of the Ahmedabad Exchange by the Central Bank of India. The Delhi Exchange is managing the clearing house departmentally for the time being, but arrangements are under way for entrusting such functions to a commercial bank.

Settlement of Forward Delivery Contracts. Forward delivery contracts can only be made in respect of those securities which are specified by the exchange for this purpose. For example, out of a total of 1,133 listed securities on the Bombay Market, 67 securities have been placed on the forward list. On the Calcutta Exchange, 19 are forward stocks out of 1,063 listed securities and on the Madras Exchange, 15 securities are on the forward list out of a total of 666 securities. Likewise, forward scrips number at 11 in Ahmedabad and 7 in Delhi. The majority of forward contracts are intended for speculative purposes. Because of the considerable time lapse between the date of entering into contracts and the date of their execution, these contracts provide a great incentive to the speculators to go in for speculative transactions. Forward dealings used to be settled in our country on a monthly basis as opposed to the practice of fortnightly settlement in the London Market. During the last week of each month, settlement was effected over a period of six days. However, at the present time fortnightly settlement has been adopted in the case of all exchanges. As the securities on forward list are traded very actively, they are invariably cleared through the clearing house. So far as the methods of settlement are concerned, there are three possible alternatives available to the parties during the fixed settlement time. *First,* the actual delivery may be taken by the buyer of securities against the full payment for securities. But this kind of settlement is rarely done by the parties, and even when this is done, the net balance is adjusted after all purchases and sales transactions have been crossed out against one another. *Secondly,* the transactions may be reversed by the offsetting sale or purchase of securities at the price ruling on the date of settlement, and the resultant price difference is only paid or received by the parties. *Thirdly,* the transactions may be carried over to the next settlement which arrives at the expiry of a fortnight. The carry-over is resorted to when the prices do not move according to the expectation of the parties concerned. This carry-over, or "budla" as it is called in our country, is effected by means of two opposite transactions. One transaction is directed to cancel or reverse the original bargain between the parties, and

the other transaction involves the remaking of the contract for its execution in the next settlement. The system of carry-over replaces the original contract by the conclusion of a new contract at a different price.

When the buyer is willing to carry over the transaction, he has to pay to the seller for the grant of this facility a consideration known as *contango* or budla charge (*Sidha budla* or *Teji budla*). The grant of this privilege amounts to an accommodation made by the seller to the buyer with a loan equal to the price of those securities which are otherwise required to be taken up and paid for by the buyer. Contango is supposed to cover the interest charge on this hypothetical loan. Similarly, the seller has to pay budla charge known as '*backwardation*' (*Undha budla* or *Mandi budla*) to the buyer, when the request for carry-over comes from the seller. The consideration for carrying over, contango and backwardation, may be paid separately or may be adjusted with the price of securities. Thus, a purchase transaction is carried over by a corresponding sale in the current settlement at the making-up price and an immediate repurchase of securities meant for the next settlement. The sale transaction is carried over by the corresponding purchase at the making-up price and a resale intended for the next settlement. In this way the original contract is settled and substituted by the formation of a new contract. The stock exchange authorities determine the making-up price as well as the budla charge in the context of prevailing market trends and the technical position of buyers asd sellers in the market.

Method of Trading on the London Stock Exchange. Both ready delivery and forward delivery contracts are allowed on the floor of the London Stock Exchange. The settlement of forward delivery contracts is made at an interval of a fortnight and the actual settlement process spreads over the last four days of the fortnight. The methods of settlement are similar to those of the Bombay Market, *viz.*, (*a*) the securities may be taken up and paid for, (*b*) the transactions may be closed by price differentiation, and (*c*) the bargain may be carried over to the next period. The carry-over procedure is almost identical with that of the Bombay Exchange, except that whereas both the offsetting transaction and the new transaction are made at the making-up price in London, the Bombay Market adopts the making-up price for cancellation purpose only. Instead of six settlement days of the Bombay Exchange, the London Market settles the forward contracts within four settlement days. The first day is called the *Contango Day* or *Making-up Day* when the carry-over arrangement is finalised. The remaining three days are required for the other two methods of settlement. The necessary ticket is prepared by the purchasing broker showing the amount and price of the security purchased and detailing the name, address and description of the transferee on the second day known as the *Name Day* or *Ticket*

Day. A formal demand for the delivery of securities is made by this ticket. The third day is the *Intermediate Day* when the ticket reaches the seller after passing through several hands. On the last day called *'Pay Day'*, the securities are taken up and paid for or their price differences are adjusted. Thus the practice of the London Market differs in two respects, viz., settlement days and the making-up price.

Stock Exchange Clearing House. The clearing house may be set up either as a separate incorporated body or as a distinct department of the stock exchange for the purpose of simplifying and facilitating the clearance of securities. It pools together all the bargains made by each member of the exchange so as to find out his resultant position ; and it traces the ultimate buyers and sellers of securities to put them in touch with each other. It ensures prompt delivery of the security to the buyer and prompt payment to the seller. The maintenance of margins on the transactions made by members can only be enforced through the operation of a clearing house. Failures and defaults to comply with the obligations of transactions or false transactions between two members can be brought down to a minimum level by an efficient working of the clearing house. Because of the buying-in and selling-out rules, it can induce a member to enforce the terms of the contract through resorting to spot purchase or sale of securities in the open market against the credit of the defaulting party. However, these buying-in and selling-out rules are suspended by the exchange authorities when manipulative and cornering activities overtake the market. As already pointed out, five out of eight recognized exchanges have set up clearing houses.

STOCK EXCHANGE SPECULATION

The stock exchange transaction falls under three categories, *viz.*, investment, speculation and gambling. Although for purposes of study, the transactions are divided into three clear-cut groups, yet in actual practice this division cannot be made in well-defined compartments. In view of the dominating role of speculation in a stock market, the nature of speculative transactions may be contrasted with that of the other two in the following way :

Speculation vs. investment—It is only a matter of motive that distinguishes a speculator from an investor. The investor desires to retain the securities for a fairly long period with the object of deriving a satisfactory return on his investment. The safety of investment becomes the first consideration to the investor who does not care much about capital appreciation. On the other hand, the speculator is little concerned with the periodical fixed income on his securities, and he purchases the security with the primary object of selling it for a profit

at the earliest opportunity. He is interested only in the price fluctuations in his securities. The speculator usually carries out his operations with the help of borrowed funds as opposed to the practice of using personal funds by an investor.

Speculation vs. gambling—The difference between speculation and gambling is based upon the ethical sense of the operators and upon their standards of knowledge, experience or financial competency. Gambling implies the taking of a hit-or-miss chance and the gambler assumes risks in the realm of unknown and unknowable. The gambler proves himself a menance and nuisance to the society. But the speculator makes his forecast with considerable accuracy by his superior knowledge and experience. He assumes the risks willingly in the hope of a corresponding large financial reward, and thereby keeps the wheels of stock exchange machinery in constant motion, bringing the beneficial results of its working.

Benefits and Evils of Speculation. It is speculation which imparts liquidity, mobility and price continuity to the securities. No stock exchange can operate continuously and provide a ready market for securities on the basis of investment transactions alone which are relatively few in number. The speculative transactions carried out day in and day out on the floor of the stock exchange give the necessary breadth and continuity to the market. Through the function of its discounting the future prospect of different industrial enterprises, speculation diverts the flow of funds to the productive channels and attracts new savings for investment into fruitful lines.

Unhealthy speculation or gambling is responsible for a great injury and much social waste, and it brings in its trail ruin or disaster to many persons. It results in violent and sudden fluctuations in security prices, sometimes with such rapidity that huge fortunes are lost or made in the course of a single day. The destiny of industrial enterprise hangs not on the profitable working of the concern, but on the balance held by the stock market. Most of the beneficial results of stock exchange operations cease to be derived. Briefly, when speculation is abused and misused by the operators, it becomes thoroughly unproductive from the social point of view.

Kinds of Speculators. Speculators may be divided into the following three classes :

Bulls—The bull speculator is an optimist who expects a future rise in prices. He goes on purchasing securities in the present market with the object of selling them on a future date at a higher price. Technically speaking, the bull 'buys long.' If the expectation of the bull materialises, he pockets the price difference without taking any delivery of securities.

On the other hand, if the price moves down in the opposite direction, he may have to bear the loss or else he may carry forward transaction by paying the contango or budla charge.

Bears—The bear speculator is a pessimist who expects a fall in the price of securities. He 'sells short' in the current market. He sells those securities which he does not possess, but expects to cover his prior sale by the subsequent purchase of securities from the market at a lower price. The bear is thus a potential buyer of securities in contrast to the bull who is a potential seller. If his expectation goes wrong, he is forced to buy back the securities at a loss or he may carry forward the transaction by paying the bulda charge or backwardation.

Stags—The stag is a speculator who neither buys nor sells securities of the company, but merely applies for securities of a new company. With the object of pocketing the premium money on the issue of securities, he applies for a substantial block of securities of the company and pays the requisite application money. The company as well as the investing public is misled by the artificial and high demand for securities which begin to sell in the market at a premium. The stag passes the shares to the investors before the time of paying the allotment money. With the removal of this artificial prop, the price of the security tumbles down to the utter dismay of the issuing company and the investing public.

Forms of Speculative Transactions. Speculative transactions are evidenced in the following four forms :

1. *Margin trading*—Forward deals are mostly done on the basis of margin trading in securities. It refers to the practice of dealing in securities by the deposit of a certain percentage of the security price as a guarantee for honouring the members' obligations. This margin deposit may be required in two different cases. The members of the exchange may demand margin from their clients who are outside dealers, and the members, in turn, may be required to maintain this margin money on their purchases and sales of securities with the clearing house as directed by the stock exchange authorities. The stock markets of our country adopted the first type of margin, and there was a total absence of the second type of margin in the past. The first type of margin ensures safety to brokers, but it does not prevent over-trading on the part of brokers. It is the members margin with the clearing house that prevents unhealthy speculations, corners and crises in the stock market. Under this margin system, the members are required to maintain constantly the fixed percentage deposit of the security price. As a result, any rise in the price reduces the margin which is made good by the deposit of a further sum. On the contrary, any fall in security price enlarges the margin which can support additional trading in securities.

Because of excessive speculation, forward trading was banned from June 27, 1969 onwards and margin trading had to be suspended. Before this suspension, the margin system was introduced on the Bombay, Calcutta, Delhi and Ahmedabad exchanges. On the Bombay and Ahmedabad exchanges, margin was demanded in the case of budla transactions only. For margin calculation, there were two bases of which the larger amount was payable by members. One basis related to the number of shares in respect of two highly speculative scrips, *viz.*, Tata Steel and Indian Iron. The other basis rested on the total value of all forward transactions budlied by the members. However, there were some free limits in both the cases and no margin was required for such free limits. The free limit for shares of Tata Steel was 4,000, for shares of Indian Iron 10,000 and for the total value of transactions Rs. 20 lakhs on the part of an individual. Beyond these limits, the margin rate was Rs. 2 for each share of Indian Iron, Rs. 10 for each share of Tata Steel, and 3 per cent on amounts up to Rs. 40 lakhs and 5 per cent thereafter. In contrast to the practice of the Bombay Exchange, the Calcutta Exchange imposed margin on all outstanding forward business in respect of the nineteen forward scrips. In the Calcutta market, the free limit was Rs. 5 lakhs. Beyond this amount, members had to pay margin at the rate of 5 per cent on the amount up to Rs. 10 lakhs and 10 per cent thereafter. On both the exchanges, however, the stock exchange authorities reserved the right to enlarge the scope as well as the rate of margin.

2. *Short-Selling*—The bear speculators indulge in short-selling; and it means the selling of something which one does not possess. Short-selling is criticised on the ground that it leads to cornering of the market, thereby injuring the interest of genuine investors. But short-selling is an integral part of speculation, and to prohibit short-selling in the securities market is to provide for the abolition of speculation altogether. There are, however, two important benefits of short-selling. It gives counter pressure to the activities of bulls in raising the market price, and consequently, it checks undue rise in security prices. Again, it pulls up a falling market which is anticipated by the short-sellers through their covering purchases during that time.

3. *Option dealing*—The Securities Contracts (Regulation) Act has made option dealing an illegal transaction. However, even in the past, option dealings were not common with the speculators of our country. Option dealing refers to the acquisition of the right to buy, to sell, or to both buy and sell securities. It differs from an outright purchase or sale of securities in that the option holder may or may not exercise his right in future. An option to buy is known as *Call Option* (or *Teji Sauda*) and an option to sell is called *Put Option* (or *Mandi Sauda*). The *Put and Call* is a double option giving the right either to purchase or to sell securities. This double option goes by the name of the *Teji-Mandi* or *Agalli* dealing in our country.

4. *Arbitrage operation*—The practice of buying and selling the

same security in different markets simultaneously with a view to making profits out of the disparity in quoted prices is known as arbitraging. When the arbitrage operations are resorted to between two markets in the same country, they are called domestic arbitrage as opposed to the foreign arbitrage which involves transactions between two markets located in different countries. Arbitrage operations tend to bring about a levelling of prices in various markets, and the stock market trnsactions present a near approach to the condition of perfect competition. With the extension of arbitrage operations beyond the national boundary, stock exchange transactions become international in character.

STOCK EXCHANGE REFORMS

As a certain amount of speculation is indispensable for the proper functioning of a stock exchange, any measure of control over speculation must provide for the retention of legitimate speculation, and at the same time, the elimination of unhealthy speculation. The objective of the control should be the regulation of speculative activities in such a way that they may not degenerate into gambling.

The Gorwala Committee has pointed out in 1951 that speculation "has a place in the organized marketing of shares, but it has a strictly limited place for strictly defined categories of person." The Committee further observed that "the essence of the regulation of stock exchanges is the control of speculation in stock exchanges and the crux of the control of speculation is its confinement to the right sphere, the right persons and the right type and volume of operations."

The Securities Contracts (Regulation) Act, 1956. The Act has come into force with effect from February 20, 1957. The object of the Act is to establish unitary control over all the stock exchanges in India by the Central Government with a view to making them really helpful for the economic development of the country. The Act applies to all securities contracts except the spot delivery contract. Spot delivery contracts have been defined as contracts that provide for the actual delivery of securities and the payment of their price either on the same day as the date of the contract or on the next day. The Government has reserved the power to regulate even spot delivery contracts under certain circumstances. As kerb trading has been made illegal under the Act, the two important kerb markets have gone out of existence, *viz.*, the Katni Market of Calcutta and the Grey Market in Bombay. Because of the grant of monopoly right to one recognized stock exchange for the purpose of security trading in each area, duplicate exchanges in some cities have also disappeared, *e.g.*, the Indian Stock Exchange, Bombay, the Bengal Share and Stock Brokers' Association, Calcutta and three

other exchanges. For persons other than members of the recognized stock exchanges in a notified area, a system of licensing on the part of security dealers has been introduced under the Act. This licensing of dealers in securities is intended to protect small and ill-informed investors against unscrupulous stock-brokers of the exchange. Option dealings have been declared illegal under the Act.

The other provisions of the Act may be studied under the following three heads :

A. *Recognition of stock exchanges*—Since the enforcement of the Act, stock exchanges that are only recognized by the Central Government would be allowed to operate in the country. The Act empowers the Government to grant recognition or to withdraw such recognition of a stock exchange. The recognition is dependent upon the rules and bye-laws complying with conditions in regard to (*a*) the proper qualifications for membership of stock exchanges, (*b*) the practice of making all contracts in writing and their enforcement in accordance with the established rules and bye-laws, (*c*) the maintenance of proper books of accounts by the members and their occasional audit by chartered accountants, and (*d*) representation of the Central Government on the governing bodies of all stock exchanges through having not more than three nominees.

B. *Powers of the Central Government over a recognized stock exchange*—The Central Government has the power (1) to call for periodical returns or to direct enquiries to be made in regard to the affairs of a stock exchange and its members ; (2) to direct the stock exchange to make rules with the previous approval of the Central Government or to amend any rules previously made ; (3) to supersede the governing body of the stock exchange ; (4) to suspend business in case of an emergency for a period of 7 days or more ; (5) to prohibit some specified contracts in securities with a view to preventing undesirable speculation ; (6) to license dealers in securities who are not members of the exchange ; (7) to stop any member of the stock exchange from acting as principal with outside dealers without the consent or authority of such persons ; (8) to compel the listing of securities in respect of public companies and to hear appeal against the refusal by stock exchanges to enlist such securities ; and (9) to enforce the submission of a copy of the annual return by the stock exchange with such particulars as may be prescribed by the Central Government.

C. *Regulation of the stock exchange through bye-laws*—The Act also attempts to regulate a number of other aspects through the bye-laws which are to be approved by the Central Government. Briefly they are stated as follows : (*i*) the determination and declaration of market rates, (*ii*) the separation between functions of jobbers and brokers and the regulation of *taravani* business, (*iii*) the regulation as to the method of entering into securities contracts between two parties, whether within

or outside the exchange, (*iv*) the fixation of a scale of brokerage and other charges including fees, fines and penalties, (*v*) the regulation and maintenance of clearing house, hours of trade and terms, conditions and incidents of contracts, (*vi*) the prevention of corners and crises by limiting the volume of business that can be done by any individual member as well as by fixing the minimum and maximum prices of securities, (*vii*) the regulation or prohibition of blank transfers and budlas, (*viii*) the obligation on the part of any member to supply any desired information to the governing body, and (*ix*) the settlement of claims and disputes by arbitration.

The Securities Contracts (Regulation) Act contains a provision by which the shareholding on blank transfer is discouraged and the registration of share transfer is indirectly encouraged. It has been provided that a registered shareholder can receive and retain any dividend on those shares which have been previously sold by him unless the buyer gets his name registered in the books of the company within 15 days from the date on which the dividend becomes due. For the risk of losing dividend on shares, the buyer would be induced to get his name registered in the books of the company. Moreover, the Companies (Amendment) Act, 1965 provides for restrictions on blank transfer. The Act requires that every instrument of transfer of shares shall be in the prescribed form bearing the date of issue stamped by the prescribed authority. The said instrument should be delivered to the company before the closure of share transfer books in the case of quoted shares and within two months from that date in the case of any other shares. Otherwise, the instrument of transfer has been made unacceptable by the company.

Directorate of Stock Exchanges. The Government of India has set up a Directorate of Stock Exchanges in 1959 with headquarters at Bombay and branch offices at Calcutta and Delhi. The Directorate has been entrusted with enforcing the regulatory measures of the Securities Contracts (Regulation) Act and realizing the objectives of the Act. Activities of the Directorate can be summarised under four heads. *First,* it maintains a close watch over the day-to-day operations of stock exchanges and requires the members to submit daily statements of their transactions and to make extra margin deposits whenever their transactions exceed specified limits. *Secondly,* it has been vested with the power of preventing kerb trading and option dealing which have been declared illegal under the Act. *Thirdly,* it ensures the strict compliance of listing requirements on the part of companies by way of furnishing all pertinent information, preventing corporate management from manipulating share prices and allotting new issues in an equitable and fair manner. *Finally,* it has been assigned the task of licensing of security dealers in areas beyond the jurisdiction of recognized stock exchanges.

Appraisal of the Reform Measure. The necessity of a measure of regulation for controlling stock market activities on an all-India basis was urgently felt over a long time. The present Act has been framed to meet that need for control. It contains rules for exercising an overall control without any detailed regulatory and restrictive provisions pertaining to any specific matter. But with a view to eliminating the defective methods and practices of stock markets, ample powers have been taken under the Act, and they can be exercised as and when necessity arises. The efficacy of this reform measure can be better appreciated through becoming familiar with the past defects and deficiencies against which it has been designed. There was much slackness in the organization of various exchanges. They weie working in an unfair competition to one another because of the absence of any centralized control as well as of the existence of multiple and unorganized exchanges in our country. Wild speculation was facilitated owing to the prevalence of several undesirable factors, such as (1) existence of blank transfer and budla facilities, (2) unrestrained activities of *taravaniwalas* and independent dealers, (3) combination of jobbing and broking functions, (4) absence of margin system and of clearing house facilities, and (5) irresponsible management by stock exchange authorities. The present Act is the outcome of investigations made by a number of Departmental Committees and finally by the Gorwala Committee in 1951. On the recommendations of the Gorwala Committee, this statute has been framed for providing a general apparatus of control over stock exchange operations in the country.

SELECT QUESTIONS

(More important questions are marked with asterisks)

CHAPTER 16 : THE CORPORATE CAPITAL STRUCTURE

*1. What do you mean by over- and under-capitalization? State briefly the evils of over- and under-capitalization and the possible remedies therefor.

*2. Set out the considerations that determine the composition of capital structure of a corporate enterprise by the inclusion of varied types of securities. (Or, what are the factors of capital gearing?)

*3. Outline the factors which determine the amount of long-term financing on the part of a new company. Discuss the significance of each factor.

*4. What is the precise meaning of working capital? Discuss the importance of adequate working capital on the part of any enterprise and point out the general factors for estimating the amount of working capital and the main determinants thereof.

5. Indicate the requirements of fixed capital in varied types and sizes of business enterprises. State the relative proportion of fixed and working capital maintained in Indian industries.

6. Outline the causes of company failures. Give an idea of the extent of company failures in India.

Chapter 17 : Financial Markets and Raising of Capital

7. Give a short account of the constituent parts of the Indian Money Market.

8. What are the important components of the Indian Capital Market? Outline the activities of industrial banks and provident funds societies in India.

*9. Account for the recent growth of capital market in India.

*10. What are investment trusts? How does the management trust differ from the unit trust? Give an idea of the working of investment trusts in the private sector in India.

*11. Discuss the organization and functions of the Unit Trust of India. Give a review of the working of the Trust.

*12. How and why has the Life Insurance Corporation of India been established? Give a critical review of the working of the Corporation.

13. Why have so many development and finance corporations been established in India? Analyse their functions and operations.

14. Discuss the sources from which large-sized industrial enterprises can raise their fixed capital.

*15. Mention and explain the sources from which large-sized industrial enterprises can raise their working capital.

16. What is the basic source of fixed capital as well as of working capital on the part of large industrial enterprises?

17. Outline the sources from which small-sized industrial enterprises can raise their fixed and working capital.

*18. What is meant by self-financing of industries? What are the benefits and limitation of self-financing? Give an idea of the extent of self-financing in Indian industries.

19. Discuss the various financial and executive considerations that are involved in deciding upon a sound dividend policy.

*20. Discuss the nature and extent of financial assistance given by the State to industries in the private sector of economy with special reference to small-scale ones.

Chapter 18 : Special Finance and Development Corporation

21. What are the objects and functions of the Industrial Finance Corporation of India? How does it acquire its investible funds? Give a brief outline of its working.

22. What are the objects and functions of the State Financial Corporations? Point out the difficulties and handicaps that prevent them from making satisfactory performances.

23. What are the ways in which the Industrial Credit and Investment Corporation of India can render its assistance tailor-made to meet the needs of every case? Give a brief idea of its working.

*24. Discuss the organization and functions of the Industrial Development Bank of India.

25. Why has the Industrial Reconstruction Corporation of India been established in 1971? Discuss the organization and functions of the Corporation.

26. Explain the objects and functions of the National Industrial Development Corporation.

*27. Analyse the role and functions of the National Small Industries Corporation for developing small-scale industries in India.

CHAPTER 19 : SHORT-TERM FINANCING AND CREDIT INSTRUMENTS

28. State the role and function of credit in business. Indicate the main sources of credit information. What are the means of making credit analysis?

29. What are the different forms of credit used in business? Explain the importance of trade credit in Indian business.

*30. Describe the different ways in which the commercial banks in India offer financial assistance to business concerns.

*31. What do you mean by instalment credit and what are the ways in which this credit is extended to consumers? Point out briefly the merits and drawbacks of sales under instalment credit.

32. Write notes on—(*a*) Endorsement on cheques, (*b*) Crossing of cheques, (*c*) Dishonour of cheques, (*d*) Inland and Foreign Bills, (*e*) Negotiation of Bills, (*f*) Promissory Notes, (*g*) Hundis, (*h*) Trade Draft, and (*i*) Bank Draft.

CHAPTER 20 : STOCK EXCHANGES

*33. Discuss the functions and services of the stock exchange in the industrial growth of a country.

34. What do you mean by security listing on a stock exchange and what is its importance? Indicate some listing requirements that are pursued in India at the present time.

*35. What are the recognised stock exchanges in India? Discuss the constitution, management and operation of any one of them. Briefly describe the nature of business transacted on a stock exchange.

36. Explain how the membership list is divided into different categories on the Indian stock exchanges as well as on the London Stock Exchange.

37. What are the different methods of trading on a stock exchange? How do the ready delivery contracts differ from the forward delivery contracts?

*38. What are the forms of speculative transactions on a stock exchange? Discuss briefly the benefits and evils of speculation.

*39. What are the salient provisions of the Securities Contracts (Regulation) Act, 1956? Do you think that many past defects in the working of stock exchanges have been removed by this reform?

40. Write notes on—(*a*) Authorized clerks, (*b*) Remisiers, (*c*) Jobbers, (*d*) Stock Exchange Clearing House, (*e*) Brokers, (*f*) Contango, (*g*) Backwardation, (*h*) Bulls, and (*i*) Bears.

PART SEVEN—MANUFACTURING ACTIVITIES

CHAPTER 21

PLANT LOCATION, LAYOUT AND BUILDING

LOCATION OF INDUSTRIES

The profitable working of an enterprise is dependent largely upon the selection of that site which would enable the concern to produce at the least cost. Even a well-managed concern may find considerable difficulty in achieving success if it is located in an unfavourable site. Before making huge expenditures on the establishment of a new plant, all the relevant factors are to be taken into consideration for deciding upon the best location of the plant. The problem of location is not only confined to a new enterprise, but it affects existing enterprises also. With shifting centres of population and of market as well as with changing conditions of transport and communication, new sites are continually appearing as more economical locations for the operation of industrial enterprises. The established enterprise is, therefore, required to adjust its location by moving to a new site, or by carving out branches with changing trends of time.

The choice of a proper location involves considerations of a number of factors, some of which are regarded to be of primary importance while others are taken to be of secondary importance only. Primary factors of location usually determine the broad region or territory in which the proposed enterprise is to be set up, and secondary factors guide the selection of actual sites within a specific region or area.

Weber's Deductive Theory. It would be instructive at the outset to study the theory of industrial location propounded by Prof. Alfred Weber of Germany. Although this theory has been rejected at the present time for certain wrong assumptions, yet it contains a fine analysis of the complex problem of location. Weber classifies factors of location into two categories, *viz.*, (*a*) those which influence the regional distribution of industries, and (*b*) those which determine the redistribution of industries within a particular region by the process of agglomeration (or concentration) and deglomeration (or dispersal):

As the problem of location is concerned with the lowest cost of production, the regional location of industries is absolutely guided by

this cost consideration. Weber finds the transport cost and labour cost as the two important elements of total costs involved in the location of industrial units. The choice of location is confined to that region which would require the minimum transport cost for the movement of raw materials as well as of finished goods to and from the industrial enterprise. In between the markets for finished goods and the sources of raw materials, the dominating pull of materials or markets is determined by the nature of materials and their process of fabrication. As regards the nature of materials, they may be either 'ubiquities' or 'localized materials'. Ubiquities are common materials like brick, clay, sand, water, etc., which are available everywhere, and consequently, they do not affect the location of industries. But localized materials like iron ore, coal, lime-stone, wood, etc., are found only in certain specified regions to which industrial enterprises are attracted. This power of attraction can be ascertained by the weight-losing character of materials. Materials that do not lose much weight in the process of production have been designated by Weber as 'pure materials', and others undergoing heavy loss in weight have been called "gross materials". Industries using pure materials are usually drawn towards the sources of materials.

Cheap labour which is available only in certain areas may influence the industrial location to some extent. Weber assumes some fixed centres of labour, from which place labour cannot move to other centres. Because of this immobility of labour, industries may be drawn towards the fixed centres of labour to derive the benefits of a cheaper labour cost. About the redistribution of industries within a specified region, the agglomerative factors concentrate industries in certain parts of the region and deglomerative factors disperse industries throughout the region. Facilities of obtaining banking, insurance and marketing services as well as chances of securing external economies tend to concentrate industries in a particular area. Dispersal is the natural outcome of high concentration due to the excessive rise in rates, charges or rentals and the growth of real estate problems.

Criticisms of the theory—Weber takes into consideration only two factors, *viz.*, transport and labour, and completely ignores other important factors of location. Even in respect of these two factors, the theory is open to objection. The assumption of fixed centres of immobile labour is thoroughly unrealistic. About transport cost, differential transport rates and alternative media of transport have not been given any consideration in the theory. Moreover, localized centres of materials and fixed markets assumed in the theory are not corroborated by actual experience.

Florence's Inductive Theory. The deficiencies of the deductive theory have led Prof. Sargant Florence to evolve an inductive theory

for explaining the causes of industrial location. Florence finds the problem of industrial location more related to the distribution of occupied population of the country than to its geographical areas. Florence's theory of location is based on two new concepts *viz.,* Location Factor and Co-efficient of Localization. Location factor is concerned with finding out the relative share of different regions which are political divisions of the country in having the different industries located in such regions. Location Factor for each region is calculated by dividing the proportion of any industry's workers in the region by the proportion of total industrial workers in that region. Where an industry is evenly distributed throughout the country, the location factor for each region would be unity. If the industry is not evenly distributed, the location factor will be either above unity or below unity. Regions showing location factors above unity or below unity would indicate that such regions have a higher share or a lower share of the industry than what should have been the case.

Co-efficient of localization is concerned with finding out an industry's tendency for concentration or dispersal. Co-efficient of localization for an industry is obtained by dividing the positive or negative deviations of the regional proportion of workers in the particular industry from the corresponding regional proportion of workers in all industries by 100. Industries which are concentrated in certain region will have high co-efficient of localization and industries dispersed in different regions will have low co-efficient of localization. By calculating the co-efficient of localization for all industries, they can be divided into three categories of high, medium and low co-efficient industries. Accordingly, co-efficient of localization revealing the tendency towards concentration or dispersal helps a lot in regional planning of industries in a country.

Criticisms of the theory—The inductive theory of location explains the existing state of distribution of industries in a country and it fails to provide any guide for future location of industries. The location factor is not a reliable index for measuring the degree of concentration of an industry because it is entirely based on the number of industrial workers engaged in each region. Deductive theory's assumption of fixed centres of labour is also tacitly accepted in the location factor. Co-efficient of localization reflects the pattern of industrial distribution which is bound to vary from country to country.

GENERAL FACTORS OF LOCATION

There are a great many factors of location that should be weighed in the balance to find out the best possible site. The mere enumeration of factors without specifying their comparative importance does not clarify our understanding. According to the importance of various

factors of location, they may be divided into groups of primary and secondary ones. There are five factors of primary importance, *viz.*, (*a*) market, (*b*) raw materials, (*c*) transporation, (*d*) labour and (*e*) power. The remaining factors usually exert a secondary influence on the location of industries. Some of the important secondary factors are : (*i*) financial facilities, (*ii*) water supply, (*iii*) climatic condition, (*iv*) topography of the site, (*v*) cost of land and building, (*vi*) historical accidents, (*vii*) artificial advantage in regard to tax rates or subsidies, (*viii*) storage and other service facilities, and (*ix*) personal preferences.

Primary Factors. 1. *Market*—As goods are manufactured with the object of selling them in the market, an easy access to the market becomes the first consideration in the choice of an industrial location. The access to the market becomes easy when products can be delivered promptly to meet the demand of consumers without incurring heavy transportation charges. The actual market may be situated thousands of miles away from the producing centre, provided the marketing cost does not become prohibitive and the facility of rendering service is not lost. Accessibility to markets is more important in the case of industries manufacturing consumers' goods rather than producers' goods, since consumption goods call for constant adjustment of manufacturing programme with changing habits and customs on the part of consumers. When the finished product is bulky, heavy or perishable, it is usually cheaper to produce near the market. Again, industries producing for a local market are also drawn towards the market. On the other hand, if the market is evenly spread over a wide area, it becomes paying to produce near the source of basic raw materials.

2. *Raw materials*—As the cost of raw materials requires a large part of the total production cost, nearness of the production centre to the source of materials is the dominant factor in many cases. Materials may be either direct or indirect ones. Direct materials enter into, and form part of finished products, whereas indirect materials do not form part of finished products and they are used as subsidiary materials. Almost all industries require a substantial quantity of indirect materials for fuelling purposes as well as for refining and packaging purposes. The proximity of the industrial site to materials is important in the case of heavy and bulky materials of small value and in the case of weight-losing materials. Also, nearness to materials is important in circumstances when transportation facilities are inadequate or costly. On the other hand, if raw materials are light, compact and cheap to transport, the market and other factors govern the location of industries. In short, the higher the proportion of the cost of raw materials to the total cost, the greater is the possibility of choosing a site near the sources of raw materials.

3. *Transportation*—Nearness to the source of materials rarely coincides with proximity to markets. Consequently, the industrial concern must have adequate transport facilities for the movement of materials and finished products to and from the plant. The selection of site is made with reference to the minimum transportation costs and the maximum transportation service. An enterprise can only receive better services and enjoy lower rates through the existence of two or more competing transport facilities. Accordingly, the junction points of railways and waterways become the humming centres of industrial activities. However, where the transportation cost absorbs a small part of the total cost of finished products, the influence of both markets and raw materials is greatly diminished on the choice of location.

4. *Labour*—The labour cost is an important item of the total production cost in many industries. For this reason, a proper consideration is given for the selection of those sites which facilitate an adequate supply of labour at a cheaper cost. So far as the supply of unskilled labour is concerned, it does not present any problem because such labour is available everywhere. Nevertheless, the question of constructing residential quarters for labour may arise in the case of some outlying areas. But skilled labour is not available in all centres, and it is usually confined to certain parts of the country. Industries which require mostly skilled labour have to adjust their location in such a way as to ensure an adequate supply of the right type of labour. The cost of labour is concerned not only with the prevailing wage level of a centre, but it is also concerned with the intelligence, dexterity and loyalty of available labour. The basic factor which works in the mind of an industrialist is the productivity of labour. This productivity is greatly affected nowadays by the activities of labour unions. The degree of union organization has now become a more important question to the businessman than the old advantage of the low wage level in certain centres, since wage differences are gradually being eliminated by legislation and union activities.

5. *Power*—For the majority of industries, power cost is the controlling factor in deciding on an industrial location. In the past, coal had an unrivalled sway over the industrial growth in a country. At present, there are, however, several other sources of power, *e.g.*, electricity, gas, oil and water power. As electric power can be carried to a great distance from its sources, industries today have been somewhat free in choosing their locations throughout the country. Coal, as a source of power, has maintained its position in those cases where carbon content becomes necessary ; but in other cases, alternative sources of power are making rapid headway. However, it is the cost factor that decides the form of power and influences the location of industrial enterprises.

Secondary Factors.—There are a large number of secondary factors, some of which may appear as important as the primary factor in certain cases. The availability of financial and banking facilities is important to concerns which require constant feeding of working capital. For the industrial unit that requires large amounts of water, the quantity as well as the quality of water supply is an important question. The favourable climatic condition and topography of the site are taken into considerations, since they render a number of benefits to the enterprise. The cost of land and buildings varies greatly from place to place. Future expansion becomes a problem in those areas where land is dear. The early start of an industry in some place is made in many cases just accidently and other industrial units are subsequently found to be attracted to such places. Some artificial advantage in respect of tax rates or industrial subsidies given by a State may induce the concern to set up business in that region. Repair services, marketing services and other auxiliary facilities are important factors in the choice of a site, specially on the part of small enterprises. Personal preferences and prejudices of the promoter may outweigh all other considerations in governing the choice for industrial location.

SPECIFIC LOCATION FACTORS

Apart from these general factors, the problem of location involves study of specific factors for different industries with their varying requirements and peculiar characteristics. In some cases, one or two primary factors may be totally absent from exercising any influence over the problem of location, and in other cases, even a secondary factor may govern the choice for location. A familiarity with the actual industrial requirements of each industry is prerequisite for understanding the factors of location in respect of a particular industry. Specific location factors of some important industries of our country may be studied so as to realize the significance of location in its proper perspective. The following six industries with their relevant factors may be examined.

Iron & steel industry—The location of iron and steel industry is governed by the relative pull of three primary factors, *viz.*, raw materials, power and market. The basic materials used in the productive process are iron-ore and coal ; besides these two materials, other materials like limestone, dolomite and manganese are used in varying quantities. Both iron-ore and coal are heavy and weight-losing materials. As these materials are required in large quantities, the industry has a tendency to be raw-materials localized rather than market localized. But certain technical developments like reduced transport cost, improved process of manufacture, the use of electric furnace and the utilization of by-products of coal have increased the relative pull of the market as a strong

localizing factor in some parts of the world. Iron and steel industries of Chicago and Lake Michigan may be cited as examples. In our country, however, the location is entirely controlled by the availability of coal and iron-ore deposits. The greater importance of materials over markets can be explained by three reasons : (*a*) the costly system of inland transport, (*b*) the occurrence of iron-ore and coal deposits in close proximity, and (*c*) the extensive and diffused character of the market spread throughout the country. It may be pointed out that the cost of raw materials takes the major share of total cost of production in the case of iron and steel industry. To produce 1 tonne of pig iron, 1.6 tonnes of iron ore, 1 tonne of coke and 0.5 tonne of limestones are required.

Cotton mill industry—The important factors in the location of the cotton mill industry are marketing facility, labour cost and power requirement. As raw cotton is a pure material, it does not lose much weight in the process of production. The transport cost remains more or less the same, whether raw materials or finished products are moved from place to place. On the contrary, it being a consumer goods industry where fashion and design play an important part, the industry tends to be drawn towards the market. The labour cost is an important part of the total cost, because it constitutes as large a percentage as 20 to 27. Unlike the iron and steel industry, it does not require coal for fuelling purposes. Any form of power may supply its power requirements. With the development of railways and hydro-electric resources, many new centres have sprung up for the production of cotton goods. The choice of location has been specially influenced by the supply of cheap labour in certain parts of the country.

Jute industry—Like the cotton industry, relevant factors of location are markets, labour cost and power supply. As raw jute is a pure material, the industry need not be located near the source of materials. The jute industry is entirely localized on the banks of the Hooghly because of the combination of certain favourable factors, *viz.*, (*a*) raw jute being almost the monopoly product of the soil of Bengal, ample supply of raw materials, (*b*) easy access to both raw materials and foreign markets because of the existence of excellent water transport facilities, (*c*) supply of cheap power from near-by coal deposits at Ranigunge and Jharia, and (*d*) the presence of banking facility, storage facility and other services of the industrially advanced Calcutta centre.

Paper industry—The important factors are power supply, raw materials and markets. To produce 1 tonne of paper, the industry requires 5 tonnes of coal and 2½ tonnes of grass. In the past, the industry was concentrated in West Bengal because of the facility of near-by coal deposits and ready Calcutta market. Sabai grass was the only raw material used for the production of paper in the early period ; and this

raw material was brought down to Calcutta area from a long distance. But two technical developments have reduced the importance of Calcutta to a great extent. Instead of 'Sabai grass', bamboo pulp, wood pulp and other materials are extensively used nowadays for the production of paper and paper boards. Coal being an expensive form of power, hydro-electricity has given an added advantage to other centres in the manufacture of paper. With the growth of literacy and improvement in the economic condition of the country, the market is diffused today over the whole country.

Cement industry—The dominating factors for the location of this industry are raw materials, power and marketing facility. The principal raw materials are limestone, clay and gypsum, all of which are heavy and weight-losing materials ; and as a consequence, the industry tends to be raw-materials localized. Its power requirements are also very high, as the power cost comprises 40 to 50 per cent of the total works cost. As the industry is drawn towards the sources of raw materials, it must have adequate transport facilities for the movement of its finished products. Instead of entirely relying on the railway transport, the industry seeks alternative media of water transport. And accordingly, many cement factories have been set up near port towns.

Sugar industry—It is virtually controlled by the adequate supply of sugarcane near the production centre. Power requirement is met by the industry itself, as bagasse is utilized for fuelling purposes. Because of the perishable nature of sugarcane, the industry is required to be situated as near the source of raw materials as possible. Sugarcane is abundantly grown in U.P., and Bihar, and about 70 per cent of sugar factories have been established in these two States. In spite of the cultivation of a superior variety of sugarcane in Madras and Bombay with sucrose recovery of 13.5 per cent as compared to 11.5 per cent in U.P. and Bihar, the industry could not make much advance in the southern parts of the country. As the cultivation of alternative cash crops like groundnuts, tobacco, bananas are more paying than cane cultivation, sugarcane is not grown widely in compact blocks for permitting the operation of sugar factories in southern regions.

CONCENTRATION AND DISPERSAL OF INDUSTRIES

When industrial enterprises in the same line of production are encompassed within a small area, certain important advantages often accrue to them as a result of what have been called "economies of concentration". Industrial enterprises are assured of the supply of materials, stores and other requisites as well as of the availability of adequate skilled labour. The necessary tools and repairing services are available locally. Labour training centres and industrial research institutions often grow

up through the joint effort of localized enterprises. By-products are not thrown away as wastes, but they are utilized in the manufacture of some useful goods. It gives rise to the growth of several other industries which may be either complementary or supplementary to the main industry. It becomes feasible to secure improved public-utility services and recreation facilities. Hospital and medical services are developed, educational institutions are established, and in a number of ways, the area becomes a pleasant one to live and work in.

But the process of concentration is bound to bring in its wake some economic and social problems which affect the well-being of the entire community. Apart from economic problems of an abnormal rise in wages and in land values for such areas, it tends to create some social evils which become a straight pointer to the dispersal of industries. The strain and cost of travelling long distances for work, the inadequacy of open spaces and recreation facilities, the increasing traffic congestion, the unhealthy effects of overcrowding, smoke, dirt and noise are the attendant evils. Civic amenities of the area are lost to a great extent, and the State authorities are pressed for solving an almost impossible problem. These areas frequently turn out to be the fertile breeding grounds of disease, squalor and vice.

Government Policy on Location. The government expressed its attitude towards the problem of industrial location in the Industrial Policy Resolution of April, 1956. The Industrial Policy states that disparities in levels of development between different regions should be progressively reduced by the provision of certain positive facilities to areas which are at present lagging behind industrially. Excessive concentration puts undue strain on housing, transport and other social services, and it gives rise to the emergence of depressed areas with wide disparities in standards of living. The prosperity of the nation can only be secured by a balanced and co-ordinated development of each region. Moreover, the World War II has demonstrated the necessity of dispersal for strategic reasons. As regards control over industrial location, the Fiscal Commission of 1949-50 was of the view of regulating the "locational pattern of large-scale industries through negative measures which control the further concentration of particular industries in specified areas which are already congested or industrially over-specialized. Along with these negative measures, positive steps may be taken to increase the attractiveness of areas where it is proposed to encourage the migration of existing industries or the establishment of new ones through the provision of basic services with the assistance of the State". At the present time, the location of industrial concern is being controlled by the Government through the activities of the Licensing Committee set up under the Industries (Dev. & Reg.) Act,

1951 and of the Capital Issues Control. Moreover, the establishment of a large number of "industrial estates" throughout the country, based on the U.K. model, is designed to secure a balanced industrial growth in the country. Further, the operations of too many State enterprises are also contributing towards the dispersal of industries.

The successive Five-year Plans have shown a growing concern over the undue growth of some regions in preference to others and the resulting regional imbalances in industrial development of the country. The Planning Commission in its document, Approach to Fifth Five-year Plan, has stated that removal of regional imbalances would help in liquidating the pockets of poverty and in securing the national integration of the country. Poor infrastructure facilities and absence of external economies are deemed to be the major reason for backwardness of several areas. 217 districts of the country have been recognized as backward areas, and an intensive effort is now being made by adopting administrative, financial and fiscal incentives for encouraging the establishment of industries in backward areas.

PLANT LAYOUT

After the selection of a site, management is required to determine the layout of the plant. Layout is the arrangement of machines within a factory, the construction of which is designed to facilitate this placement of machines. Good plant layout increases the flow of work-in-process, reduces manufacturing time, lowers cost of handling materials, and ensures smooth operations of the factory. It also provides for storage areas, parking areas as well as for future expansion of the plant. There are two basic ways of arranging machines within a plant building : (1) by process and (2) by product. Before going into the details, of these layouts, it would be worthwhile to discuss the different systems of production.

Systems of Production. There are three systems of production according to which manufacturing is undertaken on a varying scale. Job production, batch production and mass production are the three systems employed in the industrial world for making goods or services available to the public. The usual scale of operation is small in the case of job production, medium in batch production and large in mass production.

Job production involves the making of peculiar, special or non-standardized product in conformity with the orders and specifications given by the customer. That is to say, it is a system of production in which products are made to customers' orders. Customers' orders are received first and production is subsequently carried on to fulfil the order. As manufacturing is dependent on the receipt of orders and as

there is no certainty of receiving orders, job production is of intermittent character. Each product is a class by itself and constitutes a distinct and separate job for production purposes. In the absence of orders being repeated or renewed, job production calls for an adjustment of tools and equipments in working out each individual job.

Batch production is concerned with the manufacture of a group, batch or lot of products on the basis of customers' orders or of expected demand for products. Batch production is essentially similar in nature to job production and has almost all its features except the quantity of production. Instead of making one single product as in job production, a batch or group of products is turned out at a time in the system of batch production. But one batch of products has no resemblance with the next batch. The basis of distinction between job production and batch production lies in product-wise variations in one case and batch-wise variations in the other. Strictly speaking, batch production is only an extension of the job production system, and they belong to the same category.

Mass production represents the system wherein continuous manufacturing of standardized products or parts is carried on for stock purposes in anticipation of future demand. Standardization is the keynote of mass production. Standardized products or parts are obtained through a standard process of production by the use of standardized materials and machines. To maintain an even and continuous flow of production, the machines and equipments are laid out in conformity with the sequence of operations required for manufacturing a particular product. To manufacture two different products, mass production utilizes two separate sets of machines for avoiding interruptions and delays in setting tools or in adjusting equipments. Consequently, mass production is usually confined within a narrow range of products.

Today's mass production is not identical with that of two or three decades back. In contrast to the old method of mass production under which standardized finished products were manufactured, the new method of mass production calls for the manufacture of standardized parts only, not the entire product. The finished parts are utilized in the assembly line for making diverse products from those common parts. Because of this new practice, the cost of production has been reduced substantially and product diversification has been raised to cater to the needs of customers.

Product and Process Layout (LINE AND GROUP LAYOUT). Industrial plants are laid out in two different ways—by products (line layout) and by processes (group layout). In the product layout, machines are arranged in the order in which they are used in the manufacture of a given product. In the process layout similar machines

are placed in one department for one distinct operation that they perform in the plant. For example, the lathe department contains all lathe machines, the drilling department comprehends all drill machines, and the grinding department accommodates all grinding machines. Similarly, there may be other specialized departments like assembling department, welding department, painting department, etc.

Product layout is based on the sequence of productive operations, and it is suitable for mass production of goods. Raw materials are continuously fed at one end of the plant, and finished products are delivered at the other end of the plant after the materials have been worked out through an uninterrupted series of operations carried on under a straight line method. This layout requires a smaller amount of inventory, eliminates cross-hauling of materials, and conserves floor-space in repetive and steady production of standardized goods. But the defects of this layout lie in the possibility of breakdowns of any one machine which may stop the working of the entire plant, and the difficulty of adjusting machines for the manufacture of any other types of product. Process layout is effective for job-order production where a variety of products is manufactured in relatively small quantities at irregular intervals and by different sequences of operations. It provides flexibility in the use of machines, facilitates maintenance, and reduces repair and servicing charges. But it involves excessive material handling and back-tracking, and the risk of delay between two operations.

With a view to securing the advantages of both types of layouts, a mixed type of layout is adopted by many concerns which arrange machines partly on the basis of product layout and partly on process layout.

PLANT BUILDING

The plant building is constructed according to the layout pattern that is to be adopted for the arrangement of machines within the building. The place and position of the building on a particular plant site are determined on a number of considerations, such as facilities of railway sidings and vehicular movement, lighting and air-conditioning, drainage and sanitation, parking and storage areas, and the provision for future expansion of the plant. In designing the building, the question of single-storeyed and multi-storeyed buildings is required to be solved.

The single-storeyed building has a number of advantages. It makes for an excellent natural illumination, facilitates expansion by the simple removal of a side wall, requires lighter foundations, and permits working of heavy machinery as well as movement of bulky products without causing any serious vibration. Again, the cost of materials handling and

work supervision becomes much less in a single-storeyed building. It provides for a greater manufacturing space due to the absence of too many columns as required to support a multi-storeyed structure. Further, it offers greater flexibility in the plant layout. Its chief disadvantage lies in the possibility of a high cost of land, and hence of manufacturing space. *The multi-storeyed building* makes an economical use of land space and gives a comparatively lower construction cost. It is well-adapted to light manufacturing, specially of the assembly type, because it permits gravity flow of materials under a vertically arranged productive sequence. On the other hand, the problem of routing materials becomes more complicated and expensive, and much time is spent by men in moving up and down and in handling materials.

ORGANIZING FOR PRODUCTION
(OR FACTORY ORGANIZATION)

Production, to be effective, requires a sound organization structure for directing, controlling and unifying the production efforts towards a common purpose. The size and complexity of the structure are, however, dependent upon the volume of production and the system of production adopted. For a medium-sized enterprise, the usual organizational arrangements are presented in the diagram given overleaf.

It can be observed from the diagram that the works manager, or production manager as he is alternatively called, is in overall charge of all production activities. Of the activities, some are staff and service functions and others are basic. Persons engaged in basic functions are concerned with direct manufacturing, and staff or service functions are designed for giving necessary advice and service to the line production personnel in their work of direct manufacturing. It appears from the diagram that the works manager delegates line authority to factory superintendents who, in turn, delegate authority to the foremen under their control. Several other staff units and positions are created in the organization structure for providing aids to actual manufacturing. The works manager delegates staff and functional authority to the production planning manager, purchasing and traffic manager, plant services manager as well as to the chief engineer and chief inspector. Cost staff and personnel staff are usually placed in the production department by their respective managers for giving direct services and advice to the production personnel.

To facilitate actual manufacturing, different staff units or positions are necessary, but they have no power of command over the line production personnel. The exact role of different staff men may be briefly stated for explaining the pattern of organization given in the diagram.

The work of production planning and control involves four steps, *viz.*, routing, scheduling, dispatching and inspection. Of these steps, the pro-

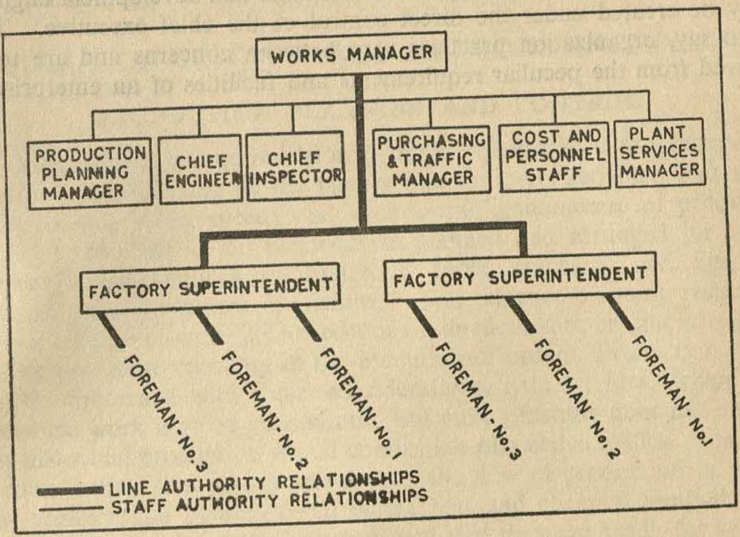


Figure 11. Chart Showing Organization of Production Activities.

duction planning manager discharges routing and scheduling functions. The dispatching function is performed by the factory superintendents and foremen. The inspection function, including statistical control, is looked after by the chief inspector. The chief engineer gives advice on the design of products and on the method and procedure of production. Buying, storing and traffic activities are entrusted to the purchasing and traffic manager. The plant services manager arranges for repairs and maintenance of tools, machines or equipments as well as for power generation. The cost staff collects and supplies costing data, while the personnel staff represents the personnel manager in giving specialized advice and service to the line executives of the production department.

Units and levels of an organization structure are dictated by the nature and volume of work. A lesser volume of work usually calls for a reduced number of units through the combination of two or more activities into one. One the other hand, a large-sized enterprise which has a great volume of production may require larger number of units than those given in the above diagram. Again, the nature of production may suggest shifting of an activity to some other places in the organization. For example, purchasing and traffic may be organized as a separate

department outside the control of works manager. Or, traffic activities may be tagged to the sales department. Where innovations in products are of utmost importance, a position of design and development engineer may be created under the direct control of the chief executive. That is to say, organization practices vary between concerns and are to be viewed from the peculiar requirements and facilities of an enterprise.

CHAPTER 22

PRODUCTION CONTROL AND METHODS ENGINEERING

PRODUCTION PLANNING AND CONTROL

Management is required to map out a well-arranged programme of production by weaving all the factors into an integrated plan that may result in qualitative, speedy and economical manufacture of products. Workers are made to do the work as planned and arranged for ; and all the physical facilities like materials, tools, machines and jigs are arranged by management in advance. This advance planning results in greater volume of work, lesser cost of production, shorter time of manufacture and more certainty in the execution of orders. Production planning is concerned with three considerations, namely, how, when and where the work is to be carried out. But mere planning does not ensure that the actual production would conform to planned activities. It is production control that guides and directs the flow of production in order that products are manufactured in the best and cheapest method, that they conform to the desired quality, and that they are ready for sale at the right time. For this purpose, management chalks out a definite course of production, fixes up the time schedule within which production is to be completed, and pursues the production line till the completion of manufacturing.

The following are the four steps involved in production planning and control :

Routing. Routing involves the determination of the way in which products are to be made and the selection of the path over which materials are to be worked out into finished products. The object of routing is to determine the best sequence or order of operations to be followed in the manufacturing process. Routing also designates the proper tools and equipments and the requisite personnel to be used in the process of production. In the case of a continuous manufacturing plant with its products layout, routing becomes automatic for standardized production with standardized operations. But in the case of job-order production and batch production, every product requires different designs and varying sequences of operations. Consequently, each product is routed separately on a sheet of paper. This route sheet indicates the sequence of operations and the machines and tools required for the production.

Scheduling. Scheduling is the fixation of time and date when each operation is to be commenced and completed. As many products consist

of several parts or components that are required to be manufactured separately in different operations, there must exist perfect co-ordination between operations so that the final assembly can be carried out in proper time. Because of the varying lengths of time required for the production of various parts or components, priorities are fixed to operations which take more time than others, or operations which are associated with the possible breakdown of machines and rejection of products.

Dispatching. Dispatching is a function which initiates the actual production as planned by the previous two steps of routing and scheduling. Dispatching gives the necessary authority to start the routed and scheduled work, and for this purpose, it issues orders, instructions and information relating to the work. Dispatching involves the allocation of materials, labour force and machines for the execution of production orders. It is also concerned with controlling productive activities in the plant. Once the work is started, it must see that production is performed in the right manner and at the right time. Dispatching ensures smooth and effective working of the plant through its controlling and remedial activities. Moreover, it is the function of dispatching to supply necessary data and information for ascertaining the manufacturing cost. In continuous manufacturing, dispatching involves a routine work associated with repetitive production. But in job-order manufacturing, each operation is a new task that raises the problem of keeping men and machines fully employed through the avoidance of all bottlenecks.

Inspection. The maintenance of quality standards is an important work of any production-control system. Finished products are subjected to an exacting nature of inspection with a view to conforming the quality of production to a predetermined standard. Defective or faulty production is rejected by the process of this inspection. As high rejections involve cost, the scope of inspection is extended very widely to cover both materials and manufacturing operations so that the number of rejections can be reduced to the minimum. Raw materials are purchased according to standard specifications and are rigidly tested before their being transformed into finished products. Similarly, machines and tools are inspected to ascertain their accuracy of performance. As the work of production proceeds from stage to stage, inspection of actual performance in each operation is consistently carried out. Thus, inspection involves the comparison of production from start to finish with a view to insuring the quality of products. This comparison of performance is always made with reference to established standards. However, the scope of inspection may vary between products or between companies. In some cases, the statistical method of random sampling is adopted, and in other cases, a hundred per cent inspection is made. In respect of

variations from standards, or tolerances as they are called, the practice may vary according to the degree of precision desired by the management personnel.

STATISTICAL QUALITY CONTROL

Quality inspection of finished products is insufficient for meeting the demands of standardized mass production. As inspection is concerned with determining the acceptability of products after manufacturing, it can neither ensure the fabrication of high precision products nor prevent the scrapping of finished products on a large scale. These deficiencies of inspection practices have led to the adoption of statistical quality control in industrial concerns, particularly those which are engaged in mass production. Statistical quality control is designed to regulate in-process manufacturing and to take corrective action in such a way that products do conform to the quality standard as they are produced. However, for the maintenance of quality standards, inspection is not replaced by statistical quality control, rather it is put on a broad-based control system by the introduction of statistical devices. The modern quality control system has three distinct functions, *viz.*, acceptance, prevention and assurance. Determining the acceptability of finished parts or products is a function of inspection, while the other two functions are encompassed in statistical quality control. Preventing quality variations from established standards and assuring quality maintenance within defined limits of errors are the two functions which centre round the *quality of conformance*. The *quality of design* is, however, beyond the scope of statistical quality control and is dealt with in inspection.

Statistical quality control, or S. Q. C., secures cost reduction in a number of ways. It saves labour and materials costs involved in scrap and rework losses, leads to greater production by economising the use of materials and labour, reduces inspection expenses, and results in securing better prices through the elimination of down-graded products. S. Q. C. is capable of wide application for detecting the assignable causes of variation in many areas of the business.

Principles of S. Q. C. Despite their attempt for making standard parts or products, industrial concerns cannot turn out products in such conformity with the established standard as to be correct to the *n*th degree. A slight variation will be revealed between products in any scheme of accurate measuring of quality standards. Some products will be a little small and some a little large, although the majority of products will rotate around the size of *central*, middle or average quality. Because of two distinct causes of variation, *viz.*, assignable cause and chance

cause, this pattern of quality difference is common in the industrial world. Assignable causes of variations are detected and corrected under the system of S. Q. C., but chance causes elude all controlling efforts. S. Q. C. assesses the magnitude of chance cause variation so as to indicate the degree of accuracy. The majority products conform to the quality standard because of the correction of assignable cause variation, while some products deviate from the standard for chance causes which are uncontrollable.

For measuring the magnitude of chance cause variations, a bell-shaped curve, or a normal curve as the statistician calls it, is obtained by plotting the frequency of product variations on a scale. The horizontal axis of the scale usually represents the degree of variations in inches and the vertical axis indicates the units of products in hundreds or thousands. For example, the degree of variations may be indicated on a scale, ranging from 0.97″ to 1.03″, with the central tendency size at 1.00″. Three different measures of central tendency, *viz.*, average, median and mode, coincide in the case of the normal curve. By plotting the frequency distributions of variations on the vertical scale, the number of products falling within the three upper deviations from 1.00″ to 1.03″ and three lower deviations from 1.00″ to 0.97″ can be ascertained. These deviations are known as standard deviation arising from chance cause. For the application of S. Q. C., control charts are constructed with upper and lower control limits for confining the actual quality to standard deviations. All deviations beyond the scale are interpreted as assignable cause variations for which remedial actions are taken.

As already pointed out, S. Q. C. is concerned with the *quality of conformance*, while inspection deals with the *quality of design*. Alternatively, the function of S. Q. C. is known as *variations inspection* and the function of inspection as *attribute inspection.*

AUTOMATION AND CYBERNETICS

Production control has entered into a new phase with the development of automation and cybernetics and they have caught the imagination of the West. They have opened an era of tremendous growth, startling performance and amazing results. Automation is an extreme form of mechanization in which machines are operated by other machines in handling and processing materials. Automation involves the replacement of the human operative whose work, skill and intelligence are transferred to the machine. The productive process can be made fully or partially automatic. With the pushing of a buttom only, a gigantic factory may go into complete production when it is fully automatized. Without any human operative to aid the productive process, materials are fed by machines, at one end, and turned out into finished products,

at the other. The automatic factory works with an incredible speed and infallible accuracy.

Cybernetics is associated with automation in respect of planning and controlling functions of management. The entire work of routing, scheduling, dispatching and inspection is done by machines. Cybernetics has been referred to as the "electronic brain" which discharges the thinking functions of management. On the other hand, automation is mainly concerned with the 'doing functions' of operatives. Cybernetics employs various mechanical, electric and electronic devices for the purpose of controlling and co-ordinating the work of automatic machines. There are four main phases of the system : (*a*) automatic reporting as to the progress of work and of deviation from standard performance, (*b*) automatic selection of remedial action in cases of normal deviation, (*c*) feedback of remedial actions to the controlling machine in the case of abnormal deviations and (*d*) automatic adjustment of the operation to obtain correct performances by the removal of deviations.

Automation along with cybernetics has found the greatest application in mass production industries with their standardized operations. But attempts are being made to introduce these automatic machines in varying circumstances and for diverse operations. The advantages of automation include reduction in direct labour cost of production, better quality production, lesser wastage of materials and more effective production control. But because of its high initial cost, replacement cost and maintenance cost, automation may remain confined to a limited number of cases. Although it may result in increasing the standard of living, the fear of technological unemployment and the requirement of non-stop work through the introduction of three-shift production are the two difficulties of automation.

METHODS ENGINEERING

Methods engineering is concerned with devising satisfactory methods through analytical study and observation. For purposes of devising methods, methods standardization and work simplification are the two important tasks of methods engineering. Before going into the discussion of these two aspects, a brief study may be made about the use of methods.

Use of Methods. Methods are widely used in manufacturing operations, though they are applicable to every field of endeavour. As a matter of fact, methods are an invariable accompaniment of a procedure. Procedures give rise to several tasks that are dealt with by methods. As the strength of a chain is determined by its individual links, methods likewise go to increase the effectiveness and usefulness of a procedure. The

key to better performance, to better productivity, and hence to better standard of living lies in improving methods.

Methods are improved by analysing the way of doing a particular task. Familiarity with the work process, understanding of the work situation, and technical knowledge about the work and its facilities are prerequisite things to any systematic study of a piece of work. Work study leads to the elimination of all wasteful, unnecessary and ineffective efforts ; it establishes the one best way of doing jobs by removing all unsatisfactory working conditions ; and it standardizes the best method for future guidance and job training. In other words, methods standardization involves the adoption of the best possible conditions with respect to all physical factors affecting the operation. As methods standardization implies the provision of desirable machines, tools and materials to do the job efficiently, it results in securing an increased output at a lesser cost and in giving the workers their legitimate share in the earnings. Because of the accurate measurement of work and of basing labour payment by results, standardized methods go a long way towards achieving closer labour-management co-operation and ensuring justice, fairness or equality to all concerned in matters of compensation. Furthermore, standard methods provide a reliable internal premise upon which future planning activities can be projected. Methods also become an important basis for controlling work performance.

There are a number of methods available for doing a particular job. One method that proves satisfactory under existing conditions may become redundant or ineffective with the lapse of time, because better and more economical methods of operation are being discovered continually. The pressure of competition urges the manager to search for, and to think through, new methods that offer greater possibilities in the future. Work study, with its natural offshoot—methods standardization, is not the exclusive responsibility of the production engineer or methods engineer. It is much a managerial work rather than a technical one. Through his acquaintance with diverse methods employed in doing a particular job, the manager provides imagination and ideas to the methods engineer for working out a new method. As methods are desired to give an expression and outward shape to the objectives of the enterprise, it is incumbent upon the managers to map out a broad picture of things that would take place in the foreseeable future. Moreover, it is precisely the exclusive jurisdiction of managers to maintain suitable operating conditions and workers' morale, the vital contributory to any good method of work, and hence to work performance.

METHODS STANDARDIZATION

Methods standardization implies the selection of the one best way

of doing a specific task and the repeated use of that method in doing the job throughout the organization. The best way of doing a job must be judged in the context of time used, costs involved, and efforts given for performing the work. Accordingly, time study, motion study, and environment study are the important aspects of work study for the purpose of devising methods. The important steps in devising methods for a manufacturing enterprise may be stated as follows :

1. *Study and analysis of the work process*—The process of work is subjected to a close study to find out the requirements and facts of the case. The scope of work study naturally varies according to whether the work is already existing or the work will be put into execution in future. In the case of an existing work, different jobs and their mode of execution are placed under observation to obtain a complete list of operations performed, of machines, tools and materials utilised, and of time taken by several workers in doing their job. These data provide clues to the experienced analyst for suggesting the lines along which improvements can be sought. But in the case of a new job, details cannot be expected. An imaginary method of doing the job is to be established by balancing the physical facilities with the requirements of the work. The requirements of the work are revealed by breaking the job into its constituent operations which clearly show what machines, tools, services and other facilities are to be utilized in the work process. From the available facilities the projected method is built up along with the fixation of time standards for each operation.

2. *Study of the work situation*—The total environment of the work place is a matter of prime concern in designing methods. Working conditions must be favourable to health, safety, comfort and sustained labour. Morale of the workers is equally important as the physical conditions are. Human relations aspect should be given adequate attention for maintenance of high morale. In addition of these, the pattern of departmental layout within the broader setting of plant layout, is to be reviewed to see that a steady flow of materials, tools and other requisites is ensured. All possible delays and unnecessary efforts in handling material are to be avoided in any scheme of methods improvement. Furthermore, machines and tools are to be properly selected and maintained for securing adequate performance. Materials too must be procured with such specifications as to have satisfying quality. All these factors are important determinants of the way the work can be done.

3. *Motion Study*—Gilbreth developed the principles of motion study for obtaining an increased output through the avoidance of unnecessary motions and undue fatigue. These principles of motion study offer tremendous possibilities to the enterprises which are engaged in mass production or process production on a continuous basis. But motion

study is not called for in the case of small industries, particularly those which are engaged in batch production or job production. Even a refined variety of motion study under the label of micro-motion study was developed by the husband-wife team of the Gilbreths for measuring shorter motions in the mass-production factories. No doubt, it is a truism to state that improvement in total performance lies in improving the individual and constituent motions which comprise the task. Motion study aims at improving each motion or bodily movement in the execution of a task by the workers. Useless motions are eliminated by this study, and other necessary motions are adjusted in such a manner as to reduce the workers' fatigue to the minimum. Incidentally to mention, fatigue study, as a separate branch of enquiry, has been developed in recent years for reducing the exhausion of workers, and thereby increasing their efficiency over a period of time.

4. *Time Study*—For any method of doing a job to be regarded as satisfactory, it must be done in the quickest possible time. Time is a valuable consideration in production costs, and time wasted amounts to the frittering away of money. Most of the on-cost expenses are dependent upon the time use. In other words, the greater production time implies a higher cost of production, irrespective of the rate of wages. To improve methods of production, time required to do the job must be shortened as far as practicable. With this end in view, time study finds out the standard time that should be taken by a worker in completing his task. To carry out this time study, the job must be broken down into its basic elements or operations, consisting of a group of motions or bodily movements. Time fixed for individual motions is aggregated so as to establish the time for each operation ; likewise, the standard time for each job is set up from the time of its constituent parts or operations. Time study is thus interrelated with motion study and goes a long way towards eliminating unnecessary motions for the purpose of reducing avoidable delay in work execution. By providing a standard time for each task, time study supplies an equitable basis of compensation to the workers, a dependable yardstick for measuring workers' performance for control purposes, and a reliable planning premise for projecting a future course of action.

5. *Development of methods*—The method is designed from the results of these different studies. The development of a method centres round the organization of tasks. To organize tasks on a proper basis, sequence of motions and integration of motions are the two important factors that call for attention of the industrial engineer. Sequence of motions is to be determined in a logical order so as to maintain a steady flow of work without any disruption, delay or deadlock. It is the sequence arrangement that makes the work easy for execution and learning ; it also ensures better and quicker ways of doing jobs. After the

selection of sequence order, integration of motions into different operations or into different jobs becomes a matter of prime concern. As already pointed out, a number of motions give rise to an operation, and a bundle of operations constitutes the individual job. Integration of motion becomes the basis for dividing the work between man and machine. The work which does not call for any intelligence and sense of responsibility on the part of operators is totally unfit for allocation to a human being. Such work cannot be done efficiently by the rational human beings. Urwick has aptly observed, "No amount of checking and inspection can overcome the proneness to error begotten of boredom."[1] Such mechanical work must be performed by machines, thus leaving the workers free to perform any work that makes at least some demand on their intelligence, skill and judgment. As it is economical to integrate as many motions as possible into one step, jobs for the individual workers are to be organized in the light of this economy consideration. Just how many motions can be integrated into one job is a matter of practical feasibility, depending upon the capacity of workers and the nature of the work. Usually where the requirement of mental labour predominates over that of manual labour in a work, a far greater number of motions can be integrated into one job in comparison with those cases which present a reverse situation.

6. *Training in new methods*—New methods must be brought within the knowledge and practice of the workers, otherwise they are of no avail. To make the workers proficient in new methods, they must be given sufficient training for the purpose. Job training within industry is the usual practice of grooming workers with all companies. The essence of training lies in explaining, demonstrating and guiding workers in the performance of new jobs and in checking upon their results. That is to say, standardization of methods is incomplete unless the workers are made accustomed to the use of prescribed method in their execution of work.

7. *Trial run of methods*—Like other plans, methods are followed up to ascertain their contribution towards work performance. This follow-up to methods points out clearly the way along which further improvement can be effected. It should not be lost sight of the fact that scope for improvements is ever present in all methods, particularly because new equipment, new tools and new materials are coming into use continually to affect the way of doing jobs in a significant manner.

WORK SIMPLIFICATION

The term "work simplification" has a wide connotation, and it applies equally to the improvement of both procedures and methods.

[1]Urwick L., *The Elements of Administration*, p. 32.

Work simplification aims at simplifying the whole work, with all its basic steps, for the purpose of securing economical, swift, smooth, and qualitative performance. All incongruities, irrelevancies and overlappings in the work process are removed so as to concentrate attention on desirable things for having greater productivity in the company. Standardization is allowed to permeate through all aspects of the work. Machines, materials, parts, processes and products, all are standardized to obtain an ever-increasing level of performance.

The concept of work simplification has come into vogue in the thirties of the present century and is the outcome of study made by the Gilbreths. Because of its close association with motion study, work simplification has been misunderstood by organized labour to be a device of speeding up, chasing workers and ultimately throwing them unemployed. Contrary to that erroneous belief, work simplification protects the workers against over-exertion and secures greater productivity through the prevention of all forms of wastes—wastes of time, space, energy and money. Work simplification holds the key to making any improvement in work either through procedures or methods. As a matter of fact, successful procedures and methods cannot be developed without simplifying the work first.

Integration of two or more steps of a procedure into one, or the integration of several motions or operations of a method into one, results in securing considerable economy of time and effort in many cases. Moreover, co-ordination of activities is much facilitated by this combination of operations. Different steps are intermeshed for having a steady as well as a speedy flow of work in the enterprise. To illustrate the practical application of work simplification, it may be pointed out that standardized parts have been developed by integrating two or more steps into one for making their use in divergent products manufactured by the automobile, electrical, farm machinery and several other industries. This principle can be extended to all industries with equal force.

Product lines and product designs have an important say in the matter of work simplification. It is suicidal for a company to undertake manufacturing of unrelated, inconsistent and odd-lot products for meeting customers' whims and peculiar tastes. Diversity of products can to some extent be maintained by the use of standardized parts in the assembly line. The practice of securing a greater diversity through the adoption of independent and separate process of production is fraught with serious difficulties and dangers. Accordingly, product lines must be chosen carefully by balancing the production facilities with the wants of customers in general. Products are designed nowadays not only for their market appeal, but also for scaling down the cost of production substantially. New materials and new techniques are utilized in improved methods of production for achieving this production economy. Product

design can be immensely helpful for reducing cost of production in several directions.

The use of machines, tools and equipment in proper places is also required in any scheme of work simplification. Mechanical work is bound to be mechanized today or tomorrow if efficiency is deemed important. Furthermore, in the case of methods improvement work simplification is first carried out on the basis of a detailed work study. However, work simplification, being wider in scope, takes into account marketing considerations as well to decide the course of action. Under work simplification, an overall analysis of the whole situation is made to take necessary remedial actions as a preliminary task to the simplification work ; and the actual simplification work proceeds from procedures to methods.

CHAPTER 23

PURCHASING AND STOREKEEPING

PURCHASING AND STOREKEEPING

Materials are an important determinant of the total cost of production and absorb as high a percentage as 70 or 80 in some cases. For the industries in general, the materials figure occupies something like 20 to 60 per cent of the total cost. It is obvious, therefore, that materials require serious attention in any work of production management. Materials do not mean stuffs in their crude state alone, but they include as well partly finished parts manufactured by other enterprises. Manufacturers of ratio sets, motor cars or typewriters often assemble the parts made by other enterprises for having a complete product. Materials cost is commonly very high in such assembling works. Again, materials may be either direct or indirect ones. Direct materials enter into, and form part of end products, while indirect materials are utilized in manufacturing and marketing for refining, fuelling, and packaging purposes. Production management calls for managerial attention on this composite group of materials.

Materials purchasing involves a number of things like the determination of quantity and quality, purchasing policies as well as procedures for purchasing materials.

Quantity and Quality. The quantity of materials to be purchased is directly related to the size of production run and is influenced by the future sales programmes, available buying facilities, existing market conditions, and prevailing price trends of materials. For production purposes, the quantity of materials must not be too high or too low. Too low a quantity may lead to delays and interruptions in manufacturing or to the total stoppage of work. On the other hand, too large quantities result in unnecessary tying of capital and other avoidable expenses due to obsolescence, deterioration or evaporation of materials as well as for store-keeping of excess materials. Between these two extremes, the correct quantity of materials is to be determined for all and every item of materials. For maintaining this correct quantity, the minimum and the maximum quantities are usually fixed for each item of the materials inventory. In addition, an ordering point is also decided upon so that inventory may not go down below the prescribed minimum because of the issue of materials for production on the one hand, and of the time taken for procuring supplies on the other.

The quality of materials is as important as the quantity is for production. Defective materials often lead to faulty production that requires rejections or scrappings. As rejections add to the cost of manufacturing, savings made through the procurement of a cheaper and inferior quality of materials become a mere eye-wash. Besides, the cases of sales returns may go up and market standing of the enterprise may be affected because of the poor quality of production arising from defective materials. To avoid the risk of losing business and of incurring additional expenses, materials are to be procured in accordance with correct specifications. For ensuring the requisite quality of materials, specifications provide the standards of colour, texture, size, shape, grade or other like features. Materials are always tested in terms of these specifications before their transformation into finished products. Furthermore, accurate materials specifications help to avoid disputes or disagreements between the company and its vendors on quality grounds. Briefly, effective purchasing implies the procurement of quality materials at satisfactory prices, and it does not mean such materials that can be obtained at the lowest or reduced prices.

Purchasing Policies. Purchasing policies are formulated by the works manager in consultation with the purchasing manager for guiding the activities of buyers. Purchasing policies provide guides as to the mode of purchasing to be adopted, the number of vendors to be counted upon, and the extent of reciprocal buying to be pursued. The following are the three modes of purchasing :

1. *Current market purchasing* implies the practice of buying from the open market according to the present requirements of production or requirements of the immediate future. This practice of purchasing acts as an insurance against the procurement of too large quantities of materials. Moreover, delivery is expedited and benefits of price fluctuations are secured by a policy for market purchasing. But it is subject to a number of limitations. First, as market purchasing is done in small quantities, the facility of quantity discounts cannot be obtained. Secondly, in difficult times satisfactory materials may not be secured. Thirdly, because of diverse sources of supply, quality of materials may vary from time to time. Finally, it involves too much paperwork and clerical labour. As the work of ordering, receiving, checking and accounting remains the same regardless of the quantity purchased, market purchasing adds to the buying expenses for procuring materials in too many lots.

2. *Contract purchasing* involves procurement of materials on the basis of fairly long-term contracts made with fixed suppliers. For future requirements of production over a year or two, contracts are entered into for supplying large quantities of materials. It assures the company

of continuous supply of materials at fixed prices. Moreover, the company is relieved of the trouble of too much record-keeping and store-keeping. On the contrary, the advantage of market price fluctuations cannot be secured and the benefit of better or improved materials cannot be availed of. For indirect materials, contract purchasing is well justified, particularly when the price level of materials is not liable to wide fluctuations.

3. *Speculative purchasing* represents buying of excess quantities at a bargain price with the object of reselling the excess part at a higher price in future. Staple commodities that are traded on the floor of organized exchanges have to be purchased on this basis. Speculative purchasing may result in large profits or large loss on buying. As the quantity purchased is far in excess of the company's requirements, the chance element of speculation creeps into the matter of buying. If future prices behave favourably, the company reaps an extra profit ; but if prices move in the opposite direction, the company suffers a heavy loss. Furthermore, speculative purchasing has a proneness towards overtrading. And this overtrading may threaten the solvency of a concern. Because of this danger, speculative purchasing is placed under the control of a senior executive of the company. However, with right checks and balances as well as within certain limits, speculative purchasing is a commendable practice and is widely adopted by industrial enterprises in procuring their materials.

NUMBER OF VENDORS : The number of sources from which materials should be obtained is another field for policy formulation in the work of materials planning. The question is whether materials are to be procured from one or two sources, or from a number of sources. The one-source procurement policy provides means of dependable deliveries, better service facilities from the vendor, satisfactory trade relationship and of buying quality materials. It has special importance in obtaining specialized materials and carries the advantage of securing materials on credit terms. But the risk of non-delivery is inherently present in one-source supply because of the possible strikes, lockouts or other forced work stoppages in the suppliers' firm. Moreover, although prices are likely to become reasonable, it does not allow to reap the benefit of competitive bidding. To overcome these defects of one-source supply, many companies have developed multi-source procurement policy, particularly from the days of World War II. The advantages of multiple sources include : (*a*) stable and continued supply of materials despite strikes, accidents, floods, fires or other calamities in the suppliers' plants ; (*b*) quality and price of materials are always compatible with current market conditions and developments ; and (*c*) sales can be improved through the trade relationships with many suppliers under a policy of reciprocal buying.

RECIPROCAL BUYING : The policy of reciprocal buying is based on the idea of give and take on the part of buyers and suppliers. It involves the choosing of those suppliers who purchase, or give encouragement to purchasing, products of the buyer. Thus buying practices provide the connecting link between the sale of products and the purchase of materials. Reciprocal buying increases sales, fosters the growth of close relationships, and simplifies the purchasing procedure. On the other hand, reciprocal buying makes the purchasing activities of secondary importance to the sale of products, prevents the procurement of best supplies from the market, and gives premium on the inefficiencies of both buyers and suppliers.

Procedures for Purchasing Materials. The purchasing procedure varies from case to case and is designed to suit the specific requirements of a particular enterprise. In any case, the major steps involved in the purchasing procedure of all enterprises may be stated as follows :

1. *Authorizing purchase* by a designated person is the first step required in buying activities. Usually, for recurring items that are fully covered by the purchasing programme, the stores section initiates action. But for special items of materials or supplies, the manager in charge of inventory control takes purchasing decisions. Whoever may be the authorized person for making decisions on the purchase of materials, all decisions must indicate the quality and quantity of materials as well as the expected time and place of delivery.

2. *Obtaining quotations* from suppliers is the second step involved in purchasing. Quotations and delivery periods are secured from a number of concerns through interviewing their travelling salesmen or making direct communications with them. Where price variations are not important and competitive bidding is deemed unnecessary, quotations are not usually obtained. Instead, the selection of actual suppliers is made from considerations like promptness and reliability of delivery.

3. *Placing of orders* is recognized as the third step in a purchasing procedure. After comparing quotations and terms of delivery, the actual order is placed with one or more suppliers. In the purchase order, certain details are included for providing requisite information and guidance to the supplier, *viz.*, the name and address of the vendor, place and time of delivery, basic price and other charges for carrying materials, the grounds for rejections and the penalty for failure to deliver in time.

4. *Follow-up and inspection* become the last step in purchasing materials. Follow-up is an act of pursuance for reminding the supplier in fulfilling his terms of sale. When the materials are delivered, they are inspected as to their quantity, quality and other specifications contained in the purchase order.

STOREKEEPING OF MATERIALS

Proper storekeeping makes it a task to see that capital is not tied up in excess or superfluous materials on the one hand, and that production is not hampered for want of materials on the other. To achieve this object of economy and prudence, levels of minimum and maximum quantity are fixed in respect of each item of materials inventory. Storekeeping involves the maintenance of quantity figures within the prescribed levels for all and every item of materials. However, to maintain these quantity levels, an ordering point is established with reference to the rate of materials consumption and the time required for further procurement. For replenishment purposes, the ordering point provides a guide as to when the purchase order should be released. Furthermore, storekeeping is also concerned with safekeeping of materials so as to prevent their loss, deterioration, depreciation or damage. But storekeeping requires expenses of its own. It is estimated in responsible quarters that storekeeping absorbs a cost varying from 10 per cent to 20 per cent of the materials cost. And this cost of storekeeping represents a sheer waste where excess materials are procured much in advance of the production programme. Rigid adherence to the maximum quantity level has thus a salutary effect on the reduction of storing cost.

Receipts and issue of materials are a sphere of storekeeping work that requires utmost care. Without being supported by a written record and a proper authorisation, no amount of materials should be allowed to come in or to go away. There are two possible sources of materials receipt. Materials are mostly received from outside vendors. But unused and surplus materials on the part of a section or a shop of the plant may also be returned to the stores. In both the cases, receipt of materials must be supported by a written account of the item. Likewise, for issuing materials, there should be a properly authorised requisition from the foremen or the superintendent. For the maintenance of quantitative record of materials, a rule is commonly established to the effect that all shops must obtain their materials directly from the store, not from the surplus materials of a neighbouring shop.

Inventory Valuation. The traditional basis of inventory valuation is to take the market price or cost price of materials, whichever is lower. Because of this rough and ready practice employed in valuing materials, it does not find favour with many managers who want to replace it by other methods. There are four methods available for the purpose, *viz.*, (*a*) first in, first out (fifo), (*b*) last in, first out (lifo), (*c*) standard cost and (*d*) cumulative average. Under the method of first in, first out, the first lot of materials purchased is supposed to be issued first and on the depletion of the first lot, issues are made from the second lot,

and so on. Lotwise prices become the basis of materials valuation. However, this method does not provide a satisfactory basis of valuation. During rising prices materials are undervalued and have no touch with the realities of market conditions. Similarly, during falling prices, materials are overvalued. Under the method of last in, first out, materials are supposed to be issued in a reverse order, commencing from the last lot. Arguments for this method are that as incoming materials are usually placed at the top of a stack or a heap, and as materials are issued from the top of the stack, the last lot of materials is actually used first for production purposes. Like the first method, it too has limitations. During rising prices it overvalues materials, while undervaluation it to be found at the time of falling prices.

Under the third method, a standard cost is ascertained for each item of materials from study, analysis and past experience. Once determined, the same cost is used in the valuation of all material issues in respect of an individual item. Any discrepancy between the standard cost and the actual price is usually adjusted in the profit and loss account under the title of "Difference in Inventory Valuation". It is an easy method to use, no doubt, but it cannot be relied upon at the time of wide price fluctuations. In the cumulative average method, a unit cost for each item is calculated by dividing the aggregate value of materials on hand by the number of units pertaining to a particular item. On the basis of prevailing unit costs, materials are valued at the time of their issue. This is the best of the four methods ; but it requires fresh calculation of unit cost, whenever further quantity of an item is acquired at different prices.

Handling of Materials. Materials handling within the plant adds to the cost of production in several ways. Besides the indirect labour cost involved in materials handling, there are costs of damaged materials, employee accidents and pilferage. The indirect labour cost on material handling goes up tremendously in those cases where travelling and back-tracking of materials are required over long distances. The flow or movement of materials is related to the type of plant layout. For effective materials handling, layout is to be designed with an eye to the flow of production and consequently to the flow of materials. Many mechanical equipments are available for efficient and economical handling of materials. It is the task of materials management to see that proper equipments are utilised in appropriate cases. By the use of mechanical equipments, the cost of materials handling can be reduced substantially. Chutes, conveyor belts, elevators, overhead cranes, crane trucks and high-lift fork truck are some of the important devices for handling materials on a large scale. Besides, there are trolleys, pallets or skids which are of common application in many manufacturing units.

Select Questions

(*More important questions are marked with asterisks.*)

Chapter 21 : Plant Location, Layout and Building

1. Discuss the deductive and inductive theories of location.

2. What are the general factors of location in deciding upon the selection of an industrial site?

3. List the specific and dominant factors of location in respect of the major industries of the nation.

4. What are the benefits and evils of industrial concentration in compact areas? Explain how the Government policy on location is conducive towards the dispersal of industries to do away with the evils of concentration.

5. "The patterns of plant layout are largely determined by the systems of production adopted." In view of the differing systems of production, indicate the applicability of product and process layout in each system of production.

*6. What do you mean by factory organization? List the important activities involved in manufacturing operations and explain with the help of a diagram how they are grouped into several units for the efficient working and control of the factory.

Chapter 22 : Production Control and Methods Engineering

*7. What is the purpose of production planning and control? Indicate the steps involved in production planning and control.

8. Explain the significance of statistical quality control in large-scale industrial undertakings. What are the basic principles of S. Q. C.?

9. The advent of automation and cybernetics has brought about radical changes in production control and has paved the way for the second industrial revolution. What are these devices and how do they work?

10. Explain the use and application of methods in manufacturing operations for increasing industrial efficiency and reducing cost of production.

11. Indicate the procedure for methods standardization in industrial undertakings. What are the contributions of work study, motion study and time study in this respect?

12. What are the aims and objectives of work simplification? Explain how it helps in eliminating wastes of resources and in reducing cost of production.

Chapter 23 : Purchasing and Storekeeping

13. Profit is as much dependent on efficient purchasing of materials as on efficient production and sale of finished goods. Do you agree with this view? Briefly discuss the important issues involved in purchasing materials.

14. What are the usual purchasing policies pursued by industrial houses for procuring their materials?

15. Explain how storekeeping on a sound basis requires (*a*) the fixation of ordering point, (*b*) the formulation of proper procedure for receiving and issuing materials, (*c*) the establishment of correct method for inventory valuation and (*d*) the use of appropriate mechanical devices for handling materials.

PART EIGHT—PERSONNEL ACTIVITIES

CHAPTER 24

PERSONNEL MANAGEMENT

MEANING OF PERSONNEL MANAGEMENT

Much confusion prevails about the precise role of personnel management in any organization. Personnel management, as the term implies, may be taken to mean the task of managing the personnel of an organization. In view of this common meaning of personnel management, the creation of a separate personnel department headed by the personnel manager has given rise to this misunderstanding. And it is assumed usually that the personnel manager is in charge of managing, *i.e.*, guiding and controlling the entire personnel of the organization. The actual position is just the reverse ; the personnel manager has no power of command, control or guidance over the people of other departments. Sales personnel are managed by the sales manager, production personnel are managed by the production or works manager, and so forth. Personnel manager is never allowed to interfere with the authority of operating managers in exercising control over their own people. What then, is the function of personnel manager ?

The personnel manager is a staff man with functional authority employed for the purpose of giving advice to other operating managers on personnel matters. It is the duty of the personnel manager to give advice to other managers who, of course, may or may not accept such advice as they please. Technically speaking, the work of the personnel manager is a staff function and has no end in itself. To assist other managers in utilizing the most precious human resources of the organization, the personnel manager advises or gives services in hiring and firing, in placing and transferring, in compensating and penalizing, in promoting and demoting, in disciplining and rewarding, as well as in training and motivating all the personnel of the enterprise. These different aspects of personnel management may be divided into the following four categories :

1. Employment functions covering selection, placement, training and promotion
2. Human relations functions required for the development of employee morale and for the maintenance of discipline and union relations

3. Employee remuneration consisting of wages, salaries, bonuses or other monetary benefits
4. Welfare activities and employee services both within and without the plant

Of these functions, the first group has been discussed in the present Chapter and the other three groups have been dealt with in the following three Chapters.

IMPORTANCE OF PERSONNEL MANAGEMENT

Management of personnel constitutes the core and centre of managerial responsibilities. As management means getting the work done by others, there can exist no management in any organization without guiding, directing and controlling the efforts of human beings. Material resources like money, machines or raw materials are worked upon by human beings ; without the support of human beings, machines remain idle, raw materials lie stacked and money gets tied up. It is these human beings who keep the business in constant motion through utilizing material resources for the creation of wealth in our society.

Effective management rests on securing spontaneous collaboration and willing support of personnel of any organization. But workers, as human beings are subject to prejudices, beliefs and emotions which regulate their capacity or will-to-work. For enlisting their best contribution for the accomplishment of tasks, human beings require fulfilment of their needs, desires and expectations. Any good and satisfactory performance cannot be extracted or forcibly demanded from rational as well as emotional human beings. To create the required work psychology, a battery of tools is employed in the sphere of personnel management. Workers are provided with many financial and non-financial incentives ; their individual and social satisfactions are aimed at through managerial communication and counselling ; and their grievances and complaints are enquired into and redressed. Briefly, personnel management calls for managerial action towards creating the will-to-do in the minds of workers.

No two men are alike in respect of their ability, intelligence or experience. Effective human performance is only practicable when right men are selected for the right jobs, and when they are trained and developed to their utmost capacity. With this end in view, personnel management focuses attention on selection, placement and training of personnel. From the date of joining to the date of leaving the organization, the workers are placed under constant care, control and guidance of management members. For discharging these managerial responsibilities involved in managing the personnel, a number of policies are formulated in regard to all facets of personnel management. These policies are executed by the departmental and sectional managers in their day-to-day

work. To aid and support other managers with specialist advice and expert services, the personnel manager occupies a key but challenging position for harmonizing the conflicting interests between the employers and the employed.

SELECTION OF PERSONNEL

The selection of personnel involves considerations on three different phases of the work, *viz.*, job analysis, sources of recruits and selection procedures.

Job Analysis. Job analysis is prerequisite to any selection of personnel. As selection is always made with reference to some fixed jobs, no recruitment is possible without analysing the job first. Job analysis discloses the requirements, responsibilities and duties involved in different jobs of an organization. Jobs differ from one another in respect of skill, experience and intelligence required as well as of hazards, physical abilities and nervous strains involved. The object of job analysis is to unfurl the make-up or composition of all jobs for classifying them into certain well-recognized groups. Not only operating jobs at the workers' level but managerial jobs also are encompassed under the scheme of job analysis. Based on the requirements and demands of different classes of jobs, man specifications are established for providing a guide to the selection of personnel. Man specifications are concerned with laying down the requisite attributes, qualities or attainment standards that are to be taken into consideration in selecting candidates for different types of jobs. Obviously, man specifications are bound to vary widely between working personnel and management personnel, or between supervisory management positions and middle management positions.

A number of benefits are obtained from the programme of job analysis. *First,* as selections are tailor-made to meet the needs and responsibilities of different jobs, cases of misfits and unfits are reduced greatly. *Secondly,* jobs being matched with qualities, traits or faculties of personnel, job satisfactions are ensured on the part of employees. And as a result, the evils of labour turnover and labour absenteeism are removed from the organization. *Thirdly,* job evaluation for determining the comparative worth of different jobs in any enterprise as well as merit rating for ascertaining the calibre and competency of different personnel is greatly facilitated by the work of job analysis. *Finally,* training and education facilities can be designed for developing the capacity of personnel when jobs are properly analysed.

Sources of Recruits. It is the task of personnel management to know the various sources of recruits and to keep regular contact with

them. As regards sources, they may be either internal or external to the enterprise. Where the policy of "promotions from within" is adopted, many important vacancies can be filled by the present employees of the organization. There are two peculiar advantages of this internal source : first, it provides a strong incentive to work for improved employee performances and acts as a builder of good morale on the part of employees, and secondly, a regular and dependable supply of qualified candidates is assured through the arrangement of training and education of employees in the organization. External source is to be tapped for filling many vacancies that may arise from expansion or growth of business, from transfer or promotion of present employees, as well as from the death or retirement of employees. External sources fall into two groups—direct and indirect. Direct sources include newspaper advertising, job-seekers at the factory gate and passed students of technical institutions, while indirect sources are composed of employment exchanges and many private employment agencies like labour contractors, jobbers, labour unions, etc. Usually, direct sources are employed for the selection of skilled and technical personnel, particularly in those cases where a separate personnel department exists in the organization. For the selection of unskilled personnel, indirect sources have been the rule with the majority of industrial enteprises in our country.

Selection Procedures. There must be definite selection procedures established for screening out the undesirable and retaining the desirable candidates. The following are the common steps involved in the selection procedure :

1. Application blanks filled in by candidates themselves recording their education, training, experience and other personal data
2. Personal interviews
3. Medical examination
4. Psychological tests.

Selection procedures in the case of managerial candidates including the supervisors are different from those applied in the case of working force. For managerial candidates, ability, personality and social traits are the three basic qualities that are appraised through the selection procedures. Ability traits are concerned with intelligence, education, training and experience of the candidate. Personality traits centre round the power to get along with people and include the attributes of firmness, determination, emotional stability and leadership. Social traits are revealed by the candidates' economic position, community status, willingness to travel and readiness to shift their residences. These different traits are appraised through all the steps in the selection procedure. But in the

case of working force, psychological tests are mostly irrelevant, and application blanks do not contain so much elaborate information as in the case of managerial candidates. Psychological tests comprise a number of formal tests like intelligence test, aptitude test, personality test, interest test, etc. For the labour force, the usual factors that are examined include training, education, experience, character, temperament, job interest, etc.

Recruitment Practices in India. Recruitment practices in our country have not developed on sound lines. Job analysis is rarely undertaken by industrial enterprises. For the selection of skilled and technical personnel, direct sources of recruits are utilized, and the number of steps in the selection procedure is cut short to three by the exclusion of psychological test. For recruiting unskilled workers, an absolute dependence is made upon outside agencies which place the requisite number of workers directly in the job without any formalities of selection procedures on the part of business concerns.

Indirect recruitment of labour is mostly effected by labour contractors and jobbers. Labour contractors are known by various names in different regions as well as in different trades or industries. For example, they are called Mukaddams in construction industries, Sardars and Kanganis in plantations, Serangs in the dockyards, and the like of them. The system of recruitment through jobbers was widely practised in the cotton textile industry in Bombay and Ahmedabad centres, and even today this system of recruitment is continued to some extent. Jobbers are usually foremen and supervisors who maintain a reserve labour force for filling vacancies caused by labour absenteeism and labour turnover. The evils of the jobbing system became so serious and widespread in character that the Bombay Government had to intervene in the matter. For regulating this practice of budli labour, several Decasualization offices have been established there and such offices act as employment agencies for filling vacancies caused by labour absenteeism and labour turnover. The defects of this indirect system of selection lie in taking bribes and illegal charges from workers, advancing loans on high rates of interest, demanding personal services and keeping the workers under subjugation.

Starting their career for resettlement of ex-service personnel in alternative jobs in 1945, employment exchanges have today become an important means of recruiting working personnel on the part of both Government and non-Government institutions. Towards the end of 1959, 248 employment exchanges were operating in the country. One hundred additional employment exchanges were opened during the Third Plan. All Government establishments at the Central and States level are utilizing the services of employment exchanges in filling their

vacancies. Industrial establishments in the private sector are not utilizing their services to a great extent. For overcoming this difficulty, the Government is putting much pressure upon the industrial enterprises to secure their personnel through the medium of employment exchanges.

PLACEMENT, PROMOTION AND TRANSFER

The personnel department selects men required by operating departments like production, sales, finance, etc. The selection of the right men for the right job is only accomplished through the placement of personnel in their respective jobs. Accordingly, job placement is as much important as personnel selection for securing adequate work performance and maintaining morale on the part of employees. Correct job placement arouses the will-to-work in the minds of employees, increases the intensity and duration of human efforts, lessens labour turnover and absenteeism, reduces industrial accidents and develops the capacity of human beings. As against these benefits, wrong placements demoralize the employees, contribute towards faulty production, increase the amount of waste in the use of materials, cause damage to tools and equipments and result in poor work performance.

Job placement is much facilitated in those cases where the jobs are suitably subdivided into grades through job evaluation. Vocational guidance by way of undertaking trade tests and ascertaining likes or dislikes of candidates can be of substantial help in the matter of job placement. Nevertheless, because of the wide margin of errors in psychological devices of trade testing or aptitude testing, an absolute reliance is never placed upon these guides. Actually speaking, job placement is finalised under a trial-and-error method by the exercise of managerial judgment and skill. After the initial placement of candidates in different jobs, a regular follow-up is practised for measuring individual performances through merit rating. According to results shown and abilities displayed, corrective measures of job placement, if necessary, are taken by way of transfer, promotions or demotions. Job placement is thus effected on a matter-of-fact basis, not solely on the mystic guides of psychology.

The problems of job placement are generally aggravated by three different situations. First where the candidates are directly placed in jobs without arranging any formal training, cases of wrong placement are bound to go up. In the absence of training facilities, candidates are not allowed to reveal their inner faculties and to demonstrate their potential capacity. Secondly, as selection is made by the personnel department for filling vacancies in other departments of the business, job placement will be as good as the degree of co-ordination that exists between the departments. Thirdly, for effecting correct job placement of employees, remedial measures are required to be taken in many cases ; but such

corrective measures can only be taken in those cases where the system of merit rating prevails in the organization.

Besides their usefulness in fixing employee remuneration, job evaluation and merit rating are invaluable tools in matters of placement, promotion and transfer. Accordingly, a brief discussion of these two tools is appropriate in the context.

Job Evaluation. Job evaluation rates the comparative worth of all jobs in an organization with reference to the amount of skill and effort required, the extent of training and experience demanded, the nature of duties and responsibilities encountered, and the state of working conditions and hazards involved in the job. Not only does it evaluate the ranks of different jobs in the order of their worth, but it also subdivides a particular job into a number of grades. For example, "drill press" is a job, requiring similar skill, experience and knowledge, as found out from the work of job analysis. But the "drill press job" may be analysed and divided further into grade one, grade two and so on, through the process of job evaluation. Because of this subdivision of jobs, placement of employees can be done in a more effective manner. Corrective measures of job placement can be taken easily by promoting employees to higher grades or demoting them to lower grades. Furthermore, wage differentials between jobs are adjusted to the satisfaction of both parties—employers and employees.

Job evaluation is effected nowadays in terms of "points system". On examining the various job requirements and responsibilities, certain points or marks are assigned to each of such job factors, and the points are subsequently aggregated to find out the comparative worth of different jobs. Corresponding to the number of aggregate points, jobs are ranked in the order of their importance. For fixing remuneration, these quantitative points are translated into financial terms and are weighed in the balance with other considerations in the matter of fixing compensation. Besides the points system, three other methods that are utilized in evaluating jobs include (*a*) job ranking, (*b*) job classification and (*c*) factor comparison.

Merit Rating. Neither job analysis nor job evaluation has to do anything with the actual performances of employed persons. Job evaluation centres round the make-up or constituents of different jobs, posts or positions without any reference to persons who occupy such positions. Leaving aside the nature and requirements of jobs, merit rating is concerned with measuring and evaluating employee performance after the candidates are placed in jobs. Since personnel are selected and placed for making adequate work performances, and since merit rating is designed for measuring actual human performances in the organization,

the system of merit rating acts as a control device ; it points out the deficiencies of employee selection and placement system. And it supplies the necessary information from performances displayed, abilities proven and temperaments shown for taking corrective actions by way of promotions, demotions or discharge. By focussing attention on performance, merit rating goes to the heart of personnel management and provides incentives towards greater performances. By basing compensation rates on the results revealed, merit rating encourages the good performers, penalises the laggards and exposes the shirkers.

EDUCATION AND TRAINING

Training of personnel contributes towards significant improvement in labour efficiency and performance, and as such it has become a recognized practice in the industrial world. Benefits of industrial training include (1) the rapid development in the capacity of workers, (2) increased production of quality goods, (3) reduction in the amount of product scrap-heaps and wastage of materials, (4) more careful handling of tools and equipments, (5) saving in managerial efforts of guidance and supervision, (6) the growth of morale, loyalty and job satisfaction on the part of personnel, and (7) fall in rates of labour turnover and absenteeism. To summarise the benefits, training results in reducing the costs of business operations to a marked degree.

Training methods vary according to the requirements of different jobs. Obviously, the training programme in regard to personnel engaged in middle management or supervisory management differs from that of the working personnel. For management personnel, the usual training methods are on-the-job training, job rotations, internal coaching, outside study courses, case studies, conferences and seminars, etc. For supervisory management personnel, the training methods include apprenticeship, role playing, supervisory letters and manuals, study courses, internal coaching, etc. During World War II, a comprehensive programme for Training Within Industry (T. W. I.) has been developed for imparting training to supervisory personnel. The T. W. I. programme consists of four different parts—job instruction training (J. I. T.), job methods training (J. M. T.), job relations training (J. R. T.) and job safety training (J. S. T.). Four "J" courses are designed for making the task of job learning easy on the part of supervisors, for training them into the techniques of methods standardization, for maintaining working relations between employees for the purpose of securing teamwork and group efforts from them as well as for arousing safety consciousness and training supervisors to detect dangers and deal with them.

Employee training methods can be divided into two groups from two different standpoints. As regards the source of training, there are

(*a*) on-the-job training, (*b*) apprentice training, (*c*) vestibule training, and (*d*) external training through a formally organized training institute. Concerning the subject matter of training, there are (*i*) induction training, (*ii*) job training and (*iii*) promotional training. These methods of training are discussed briefly as follows :

1. *On-the job training*—This is the common method of training adopted for all new candidates. The trainees are placed in specific jobs under the guidance of a supervisor or a job instructor from whom they learn the techniques and methods of the job over a period. But it may interfere with the process of work and may cause a loss of time on the part of supervisors and other employees.

2. *Apprentice training*—This is combination of classroom lectures with practical work experience in actual jobs. Classroom lectures are arranged on a part-time basis with an outside institution or within the enterprise itself. Apprentice training is usually confined to skilled workers and is spread over a period of two to six years. Terms and conditions of apprenticeship are regulated by an agreement between the parties, and some remuneration is paid to the candidates during the training period.

3. *Vestibule training*—To avoid the inconveniences of on-the-job training in regard to interference with regular work, this method calls for the running of a separate training centre within the plant. As prototype machines and equipments are used in the training centre, and as experienced job instructors are assigned for imparting training to the candidates, the rank and file workers can complete their job learning within a short period. But this training method involves too much cost because of providing similar working conditions through the use of an extra set of machines and equipments.

4. *External training*—Many vocational schools and technical institutions are run for training candidates sent by individual enterprises. Usually, such institutions give broad-based training to the candidates through classroom lectures with practical illustrations. However, this method remains mostly confined to skilled and technical personnel.

5. *Induction training*—Introduction is necessary on the part of a new employee to make him familiar with working situations and people in his group. Induction or initial training provides a broader knowledge of the company as to products manufactured, working conditions and productive processes adopted, amount of employee services and amenities available, and personnel policies and disciplinary rules in operation. This background information results in securing employee interest and providing job satisfaction to newcomers.

6. *Job training*—Job training is given in various ways to make the candidates proficient in handling machines, equipments or materials, in going through the methods of operations, as well as in avoiding accidents

or bottlenecks to performances. Job learning is the essential part of training which increases the skill, dexterity, efficiency and experience of workers.

7. *Promotional training*—For providing better incentives to work efforts and maintaining morale of employees, the recruitment policy of promotions from within the company is adopted in many cases. Where the policy of promotions from within prevails, existing employees are given promotional training for preparing them to the responsibilities of higher positions.

Training Methods in India. On-the-job training and apprentice training are arranged in some companies for filling vacancies of skilled personnel, and unskilled personnel are mostly employed without giving any training to them. Systematic efforts towards employee training were not made in the past ; even today the arrangement for training is far from adequate. Recently, three Central Training Institutes have been established at Calcutta, Bombay and Kanpur for training personnel in supervisory jobs, and similar three institutes are proposed to be established in other important centres of the country. For the training of management personnel, seven institutions have already come into existence. As training in the existing management institutes is confined to a limited number of persons and is narrower in scope, the Central Government has established three high-grade management institutes in Ahmedabad, Bombay and Calcutta centres.

EVALUATION OF PERSONNEL MANAGEMENT

Productivity of labour should be the basis for evaluating the results of personnel management. The men are selected, placed, trained and motivated for the purpose of securing high work performance from them. Accordingly, the comparative working efficiency of human beings may be taken as the yardstick for measuring managerial performance in the sphere of personnel management. But working efficiency depends upon a number of conditions. Wrong selection and placement are reflected in increasing numbers of unfit and misfit candidates. Lack of training and other work facilities is responsible for limiting the capacity of working force. If motivation is wanting in any enterprise, labour turnover and labour absenteeism are bound to go up. The cumulative effect of all personnel problems is thus witnessed in the reduced working efficiency.

Generally speaking, the capacity of human beings is conditioned by a number of factors like the rate of turnover and absenteeism, the extent of employee grievances, and the amount of financial and non-financial incentives available in the organization. (Of these factors, the questions

of turnover and absenteeism have been discussed here, deferring the discussion of other topics to subsequent Chapters).

Turnover and Absenteeism. Turnover means changes in employment from one concern to another. Labour turnover is responsible for too much drainage of funds. As the company incurs expenditure on the selection and training of each employee, it becomes a source of waste in allowing the employees to leave company's work and to join other enterprises. On the other hand, absenteeism implies sudden failure on the part of employees to join work on a particular day without any prior notice thereof. Absenteeism leads to forced stoppages of work and adds to the cost of business operations. Machines and other work facilities might remain idle for the absence of those men who are expected to join duty ; moreover, teamwork may be destroyed and other people may not get full days' work. For steady and smooth operation of an enterprise, both turnover and absenteeism cause serious detraction. Since turnover and absenteeism arise from the absence of employee satisfaction and job interest, they can be avoided to some extent by the timely actions of the personnel department. The usual remedies for labour turnover and absenteeism include sound employment policies, judicious placement, promotion or transfer, close attention to individual problems, and proper recognition of better employee performances.

Absenteeism and turnover are widely prevalent in Indian industries. Absenteeism is usually expressed in terms of percentage by dividing the actual man-days lost by the possible man-days that could be derived through a cent per cent attendance. The percentage of absenteeism generally varies from ten to fifteen in different industries. This high percentage of absenteeism is ascribed to the existence of bad living conditions, unfavourable working and service conditions as well as to the operation of jobbers and sardars. Labour turnover takes a peculiar character in India by way of shifting employment from manufacturing concerns to agricultural operations ; unlike other advanced countries, labour turnover does not amount to changing employment from one manufacturing enterprise to another. A distinct working class apart from the tillers of the land has not yet developed in our country. Because of their agricultural bias, farmers become industrial workers during the agricultural off-season ; and during sowing and harvest seasons, they revert back to villages for undertaking agricultural operations. The migratory character of Indian labour is supposed to be the main contributory to high turnover.

But the questions may be looked at from a different angle. The migration of working force is caused by the comparatively better prospects and benefits of agricultural operations, not by any inherent love

for land. If industrial concerns fail to provide necessary incentives and satisfactions to their employees, workers have no alternative but to leave their employment from such industries. Had the industrial concerns been serious about labour turnover, they would have taken remedial measures long ago for retaining their recruited personnel by way of providing suitable housing facilities, maintaining improved working conditions, and ensuring happy and contented social living on the part of workers. The management teams of different industrial concerns are perhaps not affected by the problem of labour turnover for two reasons : (*a*) existence of too many unemployed persons makes the supply of labour an irrelevant question, and (*b*) no cost is practically involved in selecting, placing or training workers in view of the fact that sardars, jobbers and other labour contractors can directly place any number of persons in jobs at the discretion of management members. Recently, however, an awakening to the realities of the situation is to be witnessed, and efforts are being made towards improvement in working and living conditions of personnel.

Labour Efficiency. The productive efficiency of Indian labour is very low as compared to that in Western countries. Comparative poor efficiency of Indian workers is assumed to be the main determinant of low industrial productivity. Labour is only one factor of productivity, and there are other equally important factors that govern the situation. That labour cannot be blamed for unsatisfactory rate of production has been pointed out by the Labour Investigation Committee (1946) in the words that "The alleged inefficiency of the Indian worker is largely a myth. Granting more or less identical conditions of work, wages, efficiency of management and mechanized equipments in the factory, the efficiency of Indian labour is no less than that of workers in most other countries."

Main causes of low efficiency—Causes of low efficiency are many and can be analysed under the following heads : (1) The *trying climate* in India is not conducive to hard and sustained work on the part of workers. The oppressive heat and humidity sap the vigour of our factory workers. (2) *Low wages* give the workers a standard of living on the borderline of subsistence. Efficiency cannot be maintained under any scheme of compensation that falls short of fair wages. (3) *Lack of training and education facilities* prevents the workers from acquiring skills required for the efficient operation of industry. (4) *Social and physical environments* in which the workers have to live make them restless and intolerant factory operatives. (5) *Working conditions* in the factory are no better than living conditions of workers. Outdated factory buildings with unscientific layout, long hours of work and fewer rest pauses go against the efficiency of workers. (6) *High labour turnover*

and absenteeism undermine the productive efficiency and increase the overhead cost of production. (7) *Management skill* is conspicuous by its absence in many small and medium-sized enterprises. Such industrial enterprises are managed by commercial and financial interests with the help of technicians who do not possess the requisite management skill. (8) *Poor equipments and materials* pull down the workers to a lower rate of efficiency. Because of the oversupply of labour force, industrial operation has become labour-intensive in character. (9) *Monetary and non-monetary incentives* are lacking in our country. Absence of incentives cannot stimulate the workers to greater productivity. (10) *Mutual distrust* of workers and management fails to enlist workers' co-operation, loyalty and goodwill.

The Labour Investigation Committee has summed up the position of labour as follows : "Considering that in this country hours of work are longer, rest pauses are fewer, facilities for apprenticeship and training rarer, standards of nutrition and welfare amenities far poorer and the level of wages much lower than in other countries, the so-called inefficiency cannot be attributed to any lack of native intelligence or aptitude on the part of workers."

CHAPTER 25

INDUSTRIAL RELATIONS

MEANING OF INDUSTRIAL RELATIONS

The term industrial relations has been used in two different senses, and as such, it has been a source of misunderstanding on the part of beginners. In the broad sense, industrial relations cover all such relationships that an industrial concern is required to maintain with different sections of the community as a whole. Industrial relations include labour relations, customer relations, public relations and so on. In the U.S.A., the term industrial relations is generally used in this broad sense. In contrast, the term industrial relations is employed in the U.K. in a narrow sense to mean labour relations only. Besides the use of terms like industrial relations and labour relations, a number of other alternative terms have gained currency for indicating the relationship between the employers and the employed, or between the managers and the managed. Labour relations is alternatively indicated by employee relations, personnel relations and human relations. Of all these terms, human relations is the best choice no doubt, because it is wide enough to include both management and non-management members of an organization and it stresses the importance of considering the employed personnel as human beings. Accordingly, the term industrial relations has been used in the present context in the sense of human relations.

AIMS OF INDUSTRIAL RELATIONS

Industrial relations aim at maintaining and developing employee motivation as well as employee morale. It is motivation that increases the workers' ability and willingness to perform and that persuades the employees towards greater efforts. For the maintenance of morale, workers are required to be provided with personal contentment and social satisfaction. For motivation purposes, however, they are to be given all sorts of incentives and stimulus to work for securing such high performances as their capacity warrants. To arouse workers' interest, zeal and enthusiasm, the incentives must look for the satisfaction of employee needs. Psychologists have classified the employee needs into four categories—*physical needs, security needs, social needs* and *self-expression needs*. Of these different kinds of needs, only physical needs can be fulfilled by financial rewards and others call for non-economic approaches. Morale and motivation are said to be correlated in popular parlance, though there is a wide difference between them. As morale is

concerned with personal contentment, satisfaction of needs creates good morale. But satisfied needs can never act as a motivator of behaviour ; it is the unfulfilled needs that motivate human beings for high performance. It is the unsatisfied need that dominates in one's thinking and provides motivation to him. Several studies have indicated that employee motivation always results in high productivity, but good morale has flopped down productivity in many cases. Although bad morale may lead to work stoppages, absence of work stoppages owing to good morale does not ensure high labour productivity. Hence, there arises the necessity for maintaining both employee motivation and employee morale.

Good morale can be maintained so long as both labour and management are satisfied with each other. But there are times when either management is displeased with labour or labour is dissatisfied with management. On such occasions, industrial relations become strained between parties and call for remedial actions. Management being the dominant party is required to take the initiative in matters of resolving their differences. If management succeeds in removing employee grievances, workers' morale is restored for the good of both labour and management. But when employee grievances cannot be met or they are ignored, industrial unrest prevails in the organization and may take the form of strikes or lockouts, thereby causing work stoppages to the detriment of both parties. However, these different aspects of industrial relations have been discussed in the following order :

1. Motivation of employees
2. Industrial discipline
3. Industrial disputes and role of trade unions
4. Settlement of disputes

MOTIVATION OF EMPLOYEES

To create the will-to-work in the minds of workers and to arouse their enthusiasm for the performance of work, employee needs are to be satisfied. It is the employee needs which regulate and control the intensity and duration of human efforts. Hence, for effective motivation of employees, recognition and understanding of employee needs and their fulfilment are of vital importance. Many and varied are the needs of human beings. As each individual is a separate entity with different outlook, desires or expectations, human needs vary widely among people. Some of the common needs are (1) fair wages, (2) employment security, (3) satisfactory service and working conditions, (4) social security against hazards of life and old age, (5) job satisfaction, (6) opportunity for development, (7) recognition and appreciation for service, (8) good

managerial attitude, (9) sense of belonging, (10) facility of participation and counselling, (11) dependable management leadership, and (12) improved social status and happy living.

Many of these human needs do not rest upon financial incentives, that is, they are personal and social needs, not economic ones. Social needs on the part of employees emerge from their working and residing at common centres. Because of their joint working in groups, employees come under a bond of common ends, beliefs and goals through their kinship, friendship or some other relationship. The present-day industrial system has increased the importance of group cohesion and social solidarity on the part of workers. The constant threats of technical and technological changes, and the fear of employment insecurity and hazards of industrial life have made the social needs no less important than the personal needs of employees.

For the motivation of employees, personal and social needs cast a significant influence and have to be satisfied by some means or others. The usual methods by which these needs are satisfied may be stated as follows :

1. *Leadership of management*—Leadership has a galvanizing effect upon human relations. Human beings, in many instances, are carried away by emotions and sentiments, not logic and facts of the situation. To overcome human emotions, leadership brings a psychological unity of workers' will and persuades them to move in one direction. As group efforts and teamwork are essential for realizing the goals of an enterprise, it is leadership that can guide, inspire and direct the group members for achieving unity of purpose and efforts. Without leadership, a group disintegrates, destroys its team spirit, and fritters away its energy.
2. *Attitudes of management*—Good human relations and along with it, high employee morale cannot be maintained by bad attitudes adopted on the part of management personnel. As workers' attitudes in an enterprise become a reflection of the attitude of its management, it is the managers who are to take the right attitude in their dealings with human beings. The will-to-do in accomplishing any work is greatly determined by the attitude of human beings. A constructive or favourable attitude contributes towards high work performance, irrespective of the calibre of human beings. In contrast, a destructive or unfavourable attitude results in poor performance, no matter how brilliant the human beings are. Consequently, it is the responsibility of all managers, not of the personnel manager alone, to adopt the right kind of attitudes towards their subordinates.

3. *Effective supervision*—First-line supervision at the employee level contributes tremendously towards the growth of good morale among people. Supervisors are referred to as front-line managers, because direct overseeing of employee performance and ordering to workers are effected by them. The entire managerial responsibility relating to work performance percolates or filters through the supervisors. Accordingly, supervisors hold the key to workers' motivation by their face-to-face contact with employees. By their understanding of individual problems and recognition of better performances, supervisors can inspire the workers towards increased efforts. Conversely, they can pull down employee performance by wrong handling of human problems or by adopting wrong attitudes. Put in brief, individual and group performances excel in those cases where the supervisors can provide dependable leadership among the employees.
4. *Informal social groups*—As the informal social groups influence the effectiveness of the work of their members and as the formation of such groups cannot be stopped, organizational arrangements are to be made conducive to the growth of such associations. Constructive utilisation of informal groups adds much to the value of formal organization.
5. *Integrating pay with social needs*—With the reasonable satisfaction of economic needs, social needs become the prime motivator of human behaviour at the operating level. For satisfying social needs, the financial incentive scheme should be designed in such a way as to increase the social solidarity of working groups by avoiding pay competition between individuals.
6. *Attention to individual problems*—Usually, unsatisfactory performances have their roots in personal grievances of employees. The stress and strains under which an employee lives and works are bound to have their repercussions on workers' morale. Setting and environment can never be neglected in appraising the efficiency of human beings. Accordingly, understanding of the personal problems and taking of remedial action can promote the growth of good morale among employees. Furthermore, attention to individual problems satisfies many of the personal wants of employees like recognition, status, importance, etc. In addition, individual attention acts as an insurance against wrong placements, unpleasant jobs and injudicious promotions.
7. *Suggestion system*—Suggestion system is a commendable means of utilizing company talents for the betterment of work perform-

ance and increasing the employee interest in the activities of an enterprise. Practical and valuable ideas are recognized by the company through the grant of cash rewards to the employees suggesting the idea. To encourage suggestions from all employees, suggestion boxes are set up in convenient places along with the supply of printed suggestion forms and writing facilities. In our country, the Tata Iron & Steel Company and some other well-organized companies have introduced this suggestion scheme which has been amply justified by significant contributions to ideas.

8. *Communication and participation*—Good communication induces the human beings to put forth greater efforts through informing, guiding and directing them in matters of work performance. Effective communication increases understanding of employees, gains their willing acceptance and leads them to higher performances. Communication also helps in giving job satisfaction to employees, in attaining their loyalty and co-operation, and in securing the desired co-ordination in their activities. Through the two-way channel of communication, an intimate touch between labour and management is maintained. Management decisions and propositions are transmitted downwards, and employee complaints and grievances are sent upwards through the medium of communication. The sense of belonging is lost in the minds of workers unless they are informed as to what management is thinking about them and their work. Furthermore, for winning employee confidence, workers too must be taken into confidence by management through an exchange of ideas, information, difficulties and developments. With this end in view, labour participation in management by way of organizing works committees or management councils has become a common practice in the industrial world.

Labour Participation in Management. At long last, labour participation in management has been found to be a cure-all remedy for solving problems of industrial relations in India. In terms of the Industrial Disputes Act, 1947, Works Committees have been formed in all those establishments which employ one hundred or more workers with equal representation from the side of labour and management. The main purpose of these Works Committees is to promote harmonious relationship between labour and management, and to settle the employee grievances at an early stage. Although the number of Works Committees reached a figure of 1,969 in 1955-56, no significant results are to be witnessed in

the labour front. Broadly speaking, Works Committees have belied the expectations that were made of them.

For enlisting workers' willing support and co-operation towards increased productivity, labour participation in management has taken a new form through the formation of joint labour-management councils. Since the inauguration of the Second Five-year Plan, the scheme of joint councils is engaging the attention of the Government. A Study Group was sent in 1956 to European countries for making on-the-spot study of practices in labour-management co-operation ; and on its return from abroad, the Study Group recommended several suggestions. The questions of forming joint councils figured prominently in the deliberations of the Indian Labour Conference held in July 1957, and a small sub-committee of four members was constituted for working out the details of the scheme. The matter was further examined by arranging a seminar on labour-management co-operation in February 1958. Out of the welter of suggestions and recommendations, joint councils have made their debut in the country. It was decided that joint councils should be formed in those enterprises which employ at least 500 workers with representatives of labour, management and technicians. Furthermore, it was pointed out that the existence of Works Committees and strong labour unions would not be a bar to the formation of joint councils ; rather operation of a well-organized workers' union is a prerequisite to the successful functioning of joint councils. Although a clear-cut sphere of activities was not prescribed for Works Committees and joint councils, it was taken for granted that Works Committees would remain busy in fostering good industrial relations, in settling common works problems and in resolving differences at the operating level of the organizations ; while joint councils would deal with overall policies in regard to welfare measures, working conditions and other related matters as well as with programmes and budgets as to work accomplishment at the highest level of the organization.

For reviewing the progress made in regard to the formation and operation of joint councils, a second seminar on labour-management co-operation was held in March 1960 at New Delhi. It was frankly admitted by the Union Minister for Labour in his address to the seminar that joint councils could not make any headway in respect of quantity or quality. Of the modest target of 50 fixed in 1957, only 24 joint councils came into existence towards the end of 1959-60, and no tangible results were derived from their operation. In the sphere of public enterprises the scheme has been engulfed with a lurking shadow. To be sure, the State enterprises were destined to take the lead in matters of forming joint councils. But up to the end of March 1961, the scheme was introduced in eleven such enterprises. The Annual Report of the Labour Ministry indicates that during 1971-72, joint management

councils were functioning in 31 public enterprises and 49 private enterprises as against the number of 46 public enterprises and 85 private enterprises in 1967-68.

No matter how the feelings of proponents of the scheme may be seriously hurt at the failure of joint councils, the outcome appears to be quite normal. For securing labour participation in management, two broad devices are joint consultation and employee counselling. Formation of both Works Committees and Joint Councils amounts to arranging for joint consultation between labour and management, not employee counselling. Any scheme of joint consultation can only succeed when employee counselling is widely practised in industrial enterprises, labour is organized into powerful unions and management members possess the requisite managerial skill. Neither of the conditions exists in our country, and hence the model of labour-management co-operation prevailing in advanced countries cannot be copied. Management skill lies in a rudimentary stage in India and is taken in many cases to be a task of manipulating funds and exploiting people. Labour unionism is split into so many blocs through the intrusion of power politics. Accordingly, the system of joint consultation has a bleak chance of success. Furthermore, personal needs are entirely neglected in any scheme of joint consultation. Leaving aside personal needs, workers cannot be motivated towards making high performances. It is employee counselling alone that can satisfy both the personal and social needs of workers. Every manager of the supervisory level must hold joint meetings or conferences with all workers of his unit so as to permit sympathetic listening, correct diagnosing and clear understanding of human problems. When the system of employee counselling becomes well established in industrial enterprises, joint consultation may bring certain beneficial results in its wake.

The National Commission on Labour (1969) also did not support labour-management joint councils. The Commission found the joint councils to be redundant machinery in view of the existing organization of works committees and recognized unions. The National Commission on Labour has suggested the extension of the powers and scope of works committees for ensuring a greater degree of consultation between labour and management instead of creating a multiplicity of joint bodies.

INDUSTRIAL DISCIPLINE

Discipline is essential for successful working and prosperity of an enterprise. Discipline creates a climate under which individual excellence is encouraged, group performance is improved and harmonious working is developed. As discipline sets a pattern of acceptable behaviour and performance on the part of human beings, good discipline promotes

individual growth, develops human capacity and stimulates the will-to-do. In the absence of discipline, productivity goes down and chaos prevails in the organization.

Discipline means working in accordance with certain recognized rules, regulations and customs, whether they are written or implicit in character. Such orderly working may be the result of self-imposed discipline or enforced discipline. In the case of self-imposed discipline, employees regulate their own conduct for the common good of the organization. Employees uphold the general interest over their individual interests and adopt helpful or co-operative attitude in the accomplishment of their jobs. Enforced discipline, on the other hand, is the result of imposition from the top. The manager exercises his authority to compel the employees to behave in a particular way. By the use of penalty or threat of penalty, the manager secures individual compliance with the established rules and regulations. As a rule, human beings are motivated to work for a peak performance under self-imposed discipline, while enforced discipline results in securing poor employee performance and has an inimical effect on the morale of workers. Nevertheless, occasions arise under which managers are compelled to rely on enforced discipline for bringing recalcitrant employees to task. However, the lesser the use of enforced discipline, the better will be the employee morale in the organization.

Causes of indiscipline are many and varied. Very often, indiscipline results from managerial faults and lapses. The common managerial faults that add to the breach of discipline are (1) adoption of varying and inconsistent disciplinary measures at different times and for different employees ; (2) deferring or neglecting the settlement of employee grievances ; (3) misjudgment and nepotism in matters of promotions and placements ; (4) failure to inform the employees as to the rules, requirements and other formalities of good discipline ; (5) sowing seeds of dissension among employees through the use of secret-police methods, and (6) failure to provide for appropriate supervision at the operating level.

For the maintenance of good discipline, the following four practices are of vital importance. *In the first place,* past offences are to be condoned after a prescribed time limit, wherever practicable. Disciplinary actions do not call for any vindictiveness or demonstration of authority on the part of managers ; on the contrary, disciplinary actions are meant for preventing the recurrence of offences in future. By the infliction of penalties, employees are never motivated towards making high performances. Opportunities must be given to all those violators of discipline or wrongdoers who want to rectify their faults. With this end in view, wrongdoers should be permitted to have a fresh start in life through the condonation of past offences after the lapse of a period

of high performances and good conduct. *Secondly,* there should be an agreement between labour and management as to the nature of disciplinary rules. As employees are vitally affected by such rules, the code of discipline containing rules and regulations is required to be framed with the approval of employees and labour unions, not by the unilateral action of management. For securing employee understanding and acceptance of such rules, the contents of the code of discipline are required to be communicated to the employees in an easy and simple language. *Thirdly,* there should be an appellate machinery in the form of a discipline committee for dealing with more serious cases of disciplinary actions. To ensure unbiased justice in an enterprise a separate discipline committee exercises a tremendous and wholesome influence on the morale of workers. *Finally,* for the successful operation of the discipline committee, the personnel department is required to supply the necessary data and facts after making thorough investigations of human problems.

The Code of Discipline in India. A countrywide Code of Discipline was evolved at the Indian Labour Conference in 1957 for removing employee grievances and settling industrial disputes by mutual negotiation, conciliation and voluntary arbitration. The Code of Discipline, having been ratified by all central labour organizations and leading employers' organizations, has come into force from June 1958. The Code is in the nature of a truce concluded between organized labour and management for creating a wholesome climate that may contribute towards better industrial relations and more satisfactory labour-management harmony. The Code was reinforced further by the Industrial Truce Resolution in 1962. The Code requires the parties to observe certain conditions like (*i*) prohibition of strikes and lockouts without notice and of recourse to acts of violence, intimidation, sabotage or go-slow methods, (*ii*) solution of problems pertaining to industrial relations by the mutual agreement of parties, not by the unilateral action of management, (*iii*) settlement of disputes through the existing machinery, and speedy implementation of all awards and agreements thereto, and (*iv*) prevention of all such actions on the part of labour and management as can embitter industrial relations between them.

The Code of Discipline could not prevent the major strikes in the steel plant at Jamshedpur, in dockyards at important ports as well as in the plantation industry in Kerala during the year 1958-59. But a Seminar on the working of the Code of Discipline held in August 1965 came to the conclusion that the Code had yielded encouraging results of success and it had worked well in the country. The working of the Code of Discipline was reviewed in August 1967 at the meeting of the Central Implementation and Evaluation Committee and the proposal to set up a National Arbitration Promotion Board for encouraging

voluntary arbitration was finalised. The Union Ministry of Labour and Employment has organized a special wing known as the Evaluation and Implementation Division for looking through the implementation of labour laws, awards and agreements and for dealing with the breaches of the Code of Discipline and of the Industrial Truce Resolution in the Central sphere.

INDUSTRIAL DISPUTES

Industrial disputes have become the concomitant of the present-day industrial system in which labour has been reduced to a factor of production to be directed and controlled along with other inanimate factors. But, in contrast to other factors, labour is supplied by human beings who are subject to emotions, feelings and reactions. As human beings, workers come forward at times with grievances that are to be redressed by the controller of any industrial enterprise. Wherever these grievances entail impossible demands on the part of workers, and as such, management refuses to pay heed to such demands, industrial disputes take roots in the enterprise.

Causes of Disputes. Industrial disputes stem in all cases from employee grievances. And these grievances centre round the workers' wants which may be economic, personal or social in nature. Very often it is found that employee wants are not expressed in their proper significance and lie obscured in their overt manifestation of symptoms like eccentric behaviour, bad attitudes and wrongful conduct on the part of workers. Accordingly, the apparent cause of industrial disputes may not be the real issue that leads the workers to enter into disputes with management. Industrial disputes are basically grounded in lack of workers' personal contentment and social satisfaction.

Industrial disputes in India have originated in certain common causes. *First*, wages and allowances constituted the most frequent reason for industrial disputes in the past, and even today wages remain as one of the major causes of industrial disputes in India. Although wages rates have been improved in recent years, all such improvements have been offset by the ever-increasing cost of living. *Secondly*, bonus payments have become so common in many concerns that any withholding of such payments has given rise to disputes. Workers expect a share by way of bonus in the increased prosperity of industrial concerns that they are deriving from the benefits of developmental planning and closed market. *Thirdly*, personnel probems involving individual and social wants of workers are emerging as the greatest cause of industrial disputes nowadays in India. *Fourthly*, terms of employment regarding leave and hours of work have caused many disputes. Violation of factory laws

and failure to maintain suitable working conditions on the part of management have aggravated the situation. *Fifthly,* bad living conditions and lack of welfare measures have made the workers hostile in attitude and intemperate in behaviour. Consequently, workers sometimes make a great fuss about trifles and disputes develop. *Finally,* industrial disputes are deeply embedded in the present-day system of production. Being divorced from the means of production, workers constantly feel a sense of insecurity in regard to hazards of life, old age and sickness or lay off. Being placed in such a social order, industrial disputes flare up in those cases where the sentiments and feelings of workers are affected. Refusal by management to recognize labour unions, victimization of labour leaders, and imposition of penalty for sympathetic strikes may be cited as causes of industrial disputes under this group.

The causes of industrial disputes in India are summarised in the following table.

ANALYSIS OF DISPUTES BY CAUSES (IN PERCENTAGE)

	1966	1967	1968	1969	1970	1971
Wages and allowances	35.8	39.9	38.4	36.0	37.1	34.3
Bonus	13.2	10.9	9.4	10.0	10.6	14.1
Personnel & Retrenchment	25.3	23.6	28.2	26.6	25.6	23.0
Leave & hours of work	2.4	1.0	1.9	2.2	2.1	1.4
Other causes	23.3	24.6	22.1	25.2	24.6	27.2
	100.0	100.0	100.0	100.0	100.0	100.0

Consequence and Extent of Disputes. Industrial disputes not only affect the parties to the disputes, viz., labour and management, but they affect the society as a whole. When industrial disputes lead to stoppages of work, both domestic and industrial consumers are deprived of their essential supplies. As a result, an industrial dispute in one concern may be responsible for creating forced idleness in other concerns for want of raw materials. Workers are deprived of their wages and of means of living. Industrial concerns suffer from the loss of income, on the one hand, and from the mounting overhead cost of business operations on the other. Industrial disputes result in lowering the amount of national income in various ways and in reducing the revenue earnings of the Government.

After the close of the World War II, industrial disputes became widespread in character and severe in extent. Workers were determined to get their grievances redressed by authorities concerned. As the trend of disputes continued unabated with their disastrous effects on national economy, the Government was compelled to come to the rescue of

industrial concerns. Since then, labour problems are engaging the constant attention of both Government and top managers of industrial enterprises. Solution of labour problems has been recognised as a prerequisite to industrial development and a key to industrial success. With this end in view, a number of measures have been initiated for ensuring happy and contented living on the part of workers.

The extent of disputes is indicated in the following table :

EXTENT OF INDUSTRIAL DISPUTES IN INDIA

Year	*No. of disputes*	*No. of workers involved (in thousands)*	*No. of man-days lost (in millions)*
1961 ..	1,357	512	4.92
1962 ..	1,491	705	6.12
1963 ..	1,471	458	3.20
1964 ..	2,151	1,003	7.72
1965 ..	1,835	991	6.47
1966 ..	2,556	1,410	13.85
1967 ..	2,815	1,490	17.15
1968 ..	2,776	1,669	17.24
1969 ..	2,627	1,827	19.05
1970 ..	2,889	1,828	20.56
1971 ..	2,752	1,615	16.55

ROLE OF TRADE UNIONS

Trade unions have become an invariable accompaniment of the capitalistic system of production in which labourers are to sell their daily labour for earning wages. Being removed from the material means of production, workers have to depend upon management for stable employment, suitable working conditions and proper amenities of life. No doubt the factory system of production has placed the workers at the complete mercy of management ; but at the same time, it has become a straight pointer to the growth of trade unionism. Trade unions have been formed by workers long ago in Western countries for protecting and promoting labour interests as well as for insuring against exploitation and maltreatment in the hands of management members. In countries where strong and well-organized trade unions have been developed, industrial disputes are both initiated and averted by the activities of trade unions. In contrast, weak trade unions can neither advance in matters of settling disputes nor retreat completely from issues of industrial disputes ; they can merely muddle for accentuating industrial disputes.

Trade unionism in India has not been allowed to grow on sound lines. As a result, the wholesome influence of trade unionism in mitigating industrial disputes has not been utilized in the country. In many cases, industrial executives oppose the growth of labour unions, and they refuse to grant recognition to trade unions. Adoption of the factory system of production and opposition to labour unionism are obvious contradictions ; such a way of thinking does not fit into the facts of the industrial world. As pointed out by the Cawnpore Labour Enquiry Committee on this point : "A strong union is an invaluable asset in several ways and is an insurance against unauthorized, irregular and lightning strikes."

Aims of Trade Unions. The aims of trade unions are to maintain and improve the conditions of workers' life, both within and without the plant, through securing better terms of employment, satisfactory work environment and greater welfare facilities. As individual workers are poor, weak and helpless to make effective bargains against the resourceful employers, workers organize themselves into trade unions for presenting a united front in matters of settling terms and conditions of industrial employment. Acting as workers' mouthpiece trade unions force the employers to negotiate with workers as a group through the system of collective bargaining. Trade unions have done immense good for the working class by way of increased wages, improved working conditions, shorter hours of work, stable employment, leave with pay and greater benefits of social security. They have made the workers class-conscious and ensured their happy and contented living in many cases. Industrial enterprises have been purged of slave-drivers and dominators by the activities of trade unions ; and for this, trade unions have paved the way towards industrial democracy in the business world. It is through the activities of trade unions that workers today are recognized as distinct industrial citizens with separate political rights and privileges of their own. By arranging training and education of their members, trade unions have increased the working capacity of labourers and thereby improved their earnings. Union funds have been utilized in extending welfare measures and group benefit schemes for the common good of all members.

Writing on the role of trade unionism, the Royal Commission on Labour in India (1931) has pointed out, "Nothing but a strong trade union movement will give the Indian workmen adequate protection. There are strict limitations to the power of Government and the public to protect workmen who are unable to protect themselves. Labour laws, indeed, find one of their most effective sanctions in the support of organized unions." The Commission succinctly stated, "it is in the power

to combine that labour has the only lasting effective safeguard against exploitation and the only lasting security against inhuman conditions."

Trade Unions in India. The trade union movement in India has practically started after the World War I and is still passing through a formative stage. Labour unions lack the character of cohesion and consolidation, and disrupting tendencies are rampant within the organization. With the object of sending delegates to the International Labour Conference, the first national federation of labour unions came into existence in 1920 under the name of "the All-India Trade Union Congress." The establishment of this central organization paved the way for gradual growth of unions in different parts of the country. The number of registered trade unions increased from 2,666 in 1947-48 to 12,744 in 1964-65 and the membership of unions increased from 1.7 million in 1947-48 to 4.4 million in 1964-65. The central organization had to undergo many trials and tribulations due to internal dissension and rivalry. The present position of trade unionism can be explained by the activities of the following four central organizations :

1. *The Indian National Trade Union Congress* (I.N.T.U.C.)—The Congress Party, in order to have control over the labour movement and to save the working class from Communist influence and ideology, started a separate organization known as I.N.T.U.C. in 1947. As a non-violent and democratic organization, it supports strikes as the last weapon when negotiation, mediation or arbitration fails to settle the dispute. It had 14,05,465 members at the end of December 1966.

2. *The All-India Trade Union Congress* (A.I.T.U.C.)—It was the first organization to be formed in 1920. As an original organization, it has popularised the trade union movement in the country. Since 1929, it is under the control of the Communist Party and has become a militant organization. It had 4,32,852 members at the end of December, 1966.

3. *The Hind Mazdoor Sabha* (H.M.S.)—The Socialist Party separated itself from the Congress Party and formed in 1948 the Hind Mazdoor Sabha, into which the Hind Mazdoor Panchayat and the Indian Federation of Labour were merged. It had 4,33,015 members at the end of December 1966.

4. *The United Trade Union Congress* (U.T.U.C.)—The Revolutionary Socialist Party has set up this organization in 1949 after making a secession from the A.I.T.U.C. It has declared to keep itself aloof from party politics. It had 93,454 members at the end of December 1966.

The four central organizations belong to the class of labour unions which are known as federal unions. Federal unions are constituted by the affiliation of many local or regional unions. Local unions may,

again, be subdivided into craft unions, company unions and industrial unions.

Weaknesses of Unions in India. The trade union movement has not progressed much in the country, and it has yet to make several strides in securing the beneficial results of unionism for the common workers. It is neither self-controlling nor financially self-supporting as yet. Labour unions are confronted with internal weakness and external oppositions. The causes of this unsatisfactory growth may be attributed to the following factors : (*i*) Abject poverty makes it difficult for the workers to pay even the small membership subscription ; (*ii*) the migratory and floating character of Indian labour fails to arouse the workers' sustained interest in the union ; (*iii*) differences of language, race and religion act as disintegrating forces in labour solidarity ; (*iv*) exacting nature of work under trying conditions does not permit the workers to take active interest in union activities ; (*v*) the systematic opposition of employers has arrested its normal growth on sound lines ; (*vi*) the workers cannot participate in union activities against the wishes of the sardars and jobbers on whom they are still dependent for facilities of employment and timely finance ; (*vii*) in the absence of workers' literacy, labour leadership falls on outsiders who are mostly narrow-minded, selfish, and even unscrupulous ; and (*viii*) political parties use the labour unions as tools in their hands to serve their political ends, and the improvement of workers' lot becomes the secondary objective of labour unions.

For overcoming the weaknesses of trade unionism in the country, some remedial measures have been suggested in different quarters. *First*, local trade unions are to be strengthened by way of amalgamating many small-sized unions into bigger ones for improving their position in respect of finance, leadership and performance. Merging of craft and company unions into industrial unions on the basis of "one union in one industry" would be conducive to the growth of labour solidarity and harmonious relations. *Secondly*, trade unions are to be saved from the ravages of power politics. Intrusion of party politics has paralysed the trade unions by introducing keen inter-union rivalries and has been responsible for creating too many splits in the labour front. *Thirdly*, trade unions must do away with the practice of using outside leadership. Competent and responsible leadership is to be developed from the working class through systematic training and guidance. *Fourthly*, the employers' attitude in matters of recognizing trade unions is to be revised or modified in the light of world experience. They are to be acquainted with the fact that management today is not taken to be what domination of the by-gone age implies. *Finally*, the need for a comprehensive statute

brooks no delay. The Trade Unions Act of 1926 cannot regulate the unions problems of the present time.

Trade Union Legislation. The Indian Trade Unions Act was passed in 1926 for legalizing trade unions that were exposed to civil and criminal liability by court decisions at that time. The Act regulates the problems of trade unionism up to the present time with certain recent changes in its provisions. The Act defines trade unions and their objectives and makes provision for the registration of trade unions. Because of the defective definition of trade unions contained in the Act, a large number of employers' organizations have registered themselves as trade unions under the Act. Registration of trade unions is not compulsory under the provisions of the Act, but it is a permissive law for extending the benefits of corporate life and perpetual existence to registered unions. Besides granting many privileges to registered unions, the Act gives immunity from civil and criminal liability to union executives in respect of those activities which are undertaken in furtherance of union objectives. For purpose of registration, any association of seven or more persons is to apply to the Registrar of Trade Unions with the name of the proposed union, its objectives and other necessary particulars. The Act imposes certain obligations upon registered unions, viz., maintenance of a list of members, utilization of union funds solely for purposes of union activities and not for political and other ends, regular audit of their accounts, election of at least half of the union executives from workers themselves and submission of annual returns to the Registrar of Trade Unions.

Although the Indian Trade Unions Act of 1926 has provided for registration of trade unions, it gives a wide latitude to employers in ignoring registered unions and in refusing recognition. Being pressed for imposing a statutory obligation on employers to recognize unions and to make negotiations with them, the Act was amended in 1947 ; but the enforcement of the Amending Act has been held in abeyance as yet. Another abortive attempt was made in February 1950 to revise and consolidate the existing measures on trade unionism by the introduction of the Trade Unions Bill. The bill has been allowed to lapse and the matter stands as it was in the Act of 1926. The discarded bill, among other things, provided for compulsory recognition of representative unions on the part of employers, obligatory registration on the part of all trade unions, and limitation of outsiders on the executive committee of trade unions to a certain fixed number. It is gratifying to note, however, that a comprehensive bill is under the active consideration of the Government.

The question of union recognition by employers figured prominently at the 16th and 17th sessions of the Indian Labour Conference held in May 1958 and in July 1959. It was pointed out that compulsory recog-

nition of trade unions would not be conducive to the growth of such conditions as are required for effective negotiations. Some of the criteria that were agreed at the conference for the purpose of union recognition include : (*a*) employers' recognition to one singular union in a particular unit should be granted liberally even when such a union fails to fulfil the condition of fifteen per cent membership (representative) or of one year's standing ; (*b*) membership condition must be fulfilled in all such cases where two or more unions exist ; and (*c*) any breach of the Code of Discipline would lead to the refusal or withdrawal of recognition for one year. The National Commission on Labour has recommended for statutory provisions for recognising trade unions in India with a view to fostering sound labour-management relations.

As regards registration of trade unions, some changes have been introduced by amending the Indian Trade Unions Act of 1926 in the year 1960. The Amending Act of 1960 provides for (*a*) the appointment of Additional and Deputy Registrars to speed up the disposal of applications for registration of trade unions, (*b*) the extension of registration even in those cases where some applicants have ceased to be members of the union, (*c*) imposition of a minimum membership fee of 25 paise per month for every member and (*d*) the Registrar's powers of verifying returns submitted by trade unions by way of inspecting account books, membership registers, etc. Another amendment in 1964 provided for (*a*) preventing persons who have been convicted of non-bailable offences from holding executive positions in registered trade unions, and (*b*) submitting annual returns by all registered trade unions on a calendar year basis. This amendment came into force from April 1, 1965.

The National Commission on Labour (1969) has crystallized its views on strengthening trade unions in India by the following ways : (*a*) elimination of party politics and outside leadership, (*b*) recognition of the majority union on the basis of either secret ballot or membership list, (*c*) promotion of collective bargaining through negotiations with the recognised union, (*d*) provision of facilities for greater union security, and (*e*) an arrangement to settle inter-union disputes by the Labour Courts. In a Conference of Trade Unions held in May 1971, although the problems of multiple unions and their rivalries were realized, no agreement was reached among the unions.

SETTLEMENT OF INDUSTRIAL DISPUTES

Labour grievances are redressed either by peaceful methods of negotiation, mediation, and arbitration or by coercive methods of strike, picketing and sabotage on the part of workers. When the workers' demand appears unreasonable, employers resort to lockouts which are the counterpart of strikes. Both strikes and lockouts lead to the stoppage

of work, and they are costly to workers as well as to employers in several ways. The society as a whole is affected by this forced idleness of industrial undertakings. Hence, industrial peace is desirable from all sides. The methods for settling disputes may be divided into two groups—voluntary methods and statutory methods.

Voluntary Methods. These successive methods that can be adopted for securing industrial peace are : (1) collective bargaining through direct negotiation, (2) conciliation and mediation, and (3) arbitration.

Trade agreement—It is the result of collective bargaining between labour and management. Trade agreement contains a body of guiding rules that determine employer-employee relations for a certain fixed period. As the mutual rights and obligations are agreed to and accepted by the parties themselves, and they are incorporated in the agreement, it provides the most effective means of securing industrial peace. However, these agreements cannot be enforced in a court of law like other agreements. The validity of trade agreement depends on the attitude of parties as well as on the attitude of the State. When both the parties are well-organized and agreements are drawn up on an equal footing, it has succeeded in settling industrial disputes.

Conciliation and mediation—When the collective bargaining fails to maintain industrial peace, conciliation and mediation efforts are applied to iron out the differences between the parties. Whereas conciliation creates favourable atmosphere for the parties to come to an agreement, mediation aims at making a compromise as to the points of their differences. Both conciliation and mediation involve corrective action for enabling the parties to make an agreement of their own.

Arbitration—When conciliation or mediation fails to resolve the difference between parties, arbitration may be used to avoid industrial strife. In arbitration, some arbiter acting in the capacity of a judge, decides the matter of dispute between parties. The decision may or may not be binding on the parties. Arbitration is of little effect when the decision is not made compulsorily acceptable by the parties. Furthermore, the reference to arbitration can be voluntary or compulsory. In compulsory arbitration, both the parties are under a statutory obligation to submit their differences to an arbiter and to accept the decisions arrived at in such a procedure.

Statutory Methods. The role of the State in matters of settling disputes is to be witnessed in legislation concerning industrial disputes. In addition, the appointment of welfare officers and labour officers is a step directed towards the settlement of industrial disputes, although such officers are engaged for rendering a number of other services. For

factories employing five hundred or more workers, the appointment of a welfare officer has become obligatory from the year 1953. Non-unionized workers can represent their grievances to labour officers appointed by the State Governments under the jurisdiction of their Labour Commissioners.

Trade disputes legislation—For the settlement of industrial disputes, the Trade Disputes Act of 1929 was the first legislation framed on the model of the British Trade Disputes Act, 1927. General strikes were declared illegal under the Act, because such strikes prevented the Government from taking any remedial action in the matter. The Act provided for the establishment of *ad hoc* Courts of Enquiry and Boards of Conciliation, as and when necessity arose for such bodies. The two bodies were made permanent by amending the Act in 1934. In addition, an arrangement for the appointment of conciliation officers was made by a further amendment in 1938.

Industrial unrest became very widespread towards the end of the Second World War. With a view to reducing the number of disputes by the establishment of preventive as well as settlement machinery, a new enactment was made in 1947, viz., the Industrial Disputes Act of 1947. As a measure of prevention, all industrial establishments with more than 100 workers are required to form Works Committees, composed of an equal number of members from the side of employers and employees for removing day-to-day grievances. As regards settlement machinery, the Act provides for the appointment of Industrial Tribunals in addition to the old arrangements of Conciliation Officers, Boards of Conciliation and Courts of Enquiry. The Act treats the ordinary industrial establishments on a different footing from that of public-utility services wherein strikes without proper notice have been made illegal. Whereas all disputes in public-utility services are to be referred compulsorily to the Conciliation Officers, disputes in other cases are taken up by the conciliation machinery wherever both parties to the dispute apply for such a procedure. The Act has also prescribed successive steps in the mode of settlement. All disputes are taken up first by a Conciliation officer who must submit his report within 14 days. On the failure of the Conciliation officers, the Board of Conciliation, consisting of an outside chairman and representatives of disputants, steps in for the amicable settlement of disputes. When the Board fails, the dispute is referred to an Industrial Tribunal, constituted by one or more persons of the rank of High Court Judges. Before the dispute is adjudicated by the Industrial Tribunal, the Government may get the case investigated within a period of 6 months by the appointment of a Court of Enquiry. During the period of conciliation efforts, the strikes and lockouts are prohibited under the provisions of the Act.

The Industrial Disputes Act of 1947 has been amended in 1950,

1953, 1956 and 1957. The Amending Act of 1950 provided for the establishment of a Labour Appellate Tribunal to hear appeals from awards and decisions of Industrial Tribunals and other Statutory Boards. The Amending Act of 1956 has abolished the Labour Appellate Tribunal and has simplified the old cumbersome methods of settlement. It provides for a three-tier machinery of Labour Courts, Industrial Tribunals and National Tribunal, all with original and separate jurisdiction. No appeal can be made against the award of these bodies ; but the Government has reserved the power to modify or cancel any award in the public interest or in the promotion of national economy.

As lay off and retrenchment result in industrial disputes, the Industrial Disputes (Amendment) Act, 1953 provides for the payment of compensation to workers who are laid off or retrenched after one year of continuous service. Lay off means the failure on the part of employers to provide their regular employees with jobs because of breakdown in machinery, shortage of coal and materials or for any other reason. Retrenchment, on the other hand, implies termination of employee employment for any reason other than for disciplinary action. The Industrial Disputes Act was amended in 1957 to provide for retrenchment compensation payable in all cases of service termination arising from *bona fide* closure or transfer of industrial undertakings.

Evaluation of measures—Legislation for the settlement of disputes has been framed with a leaning towards compulsory methods of conciliation and arbitration. Compulsory methods have been abandoned in other countries, because they deprive the workers of the right to strike and because they create difficulty in the enforcement of compulsory awards. Without removing labour grievances, industrial peace cannot be secured by prohibiting strikes or by adopting cooling off measures of a lengthy settlement process. Industrial peace in the real sense can only be maintained through direct negotiation by the parties who are vitally interested, and as such, they are likely to settle their differences in the most effective manner.

At the seventeenth session of the Indian Labour Conference held at Madras in July 1959, it was agreed to place greater reliance upon mediation and arbitration for settling industrial disputes and to avoid making references to compulsory adjudication as far as practicable. Furthermore, the Standing Labour Committee suggested in March 1960, an amendment to the Industrial Disputes Act for encouraging voluntary arbitration in the settlement of disputes. It was pointed out by the Committee that decisions of voluntary arbitration should be given the status of industrial awards for making the system of voluntary arbitration more popular in the country. To encourage voluntary arbitration in settling disputes, a tripartite body known as the National Arbitration Promotion Board has been formed in 1967. The main functions

of the Board are to review the extent of use of voluntary arbitration, to suggest measures for extending the application of voluntary arbitration and to determine the principles, procedures and personnel for such arbitration.

Views of the National Commission on Labour (1969)—The Commission has laid a greater stress on collective bargaining and conciliation for the prevention of industrial disputes rather than their settlement. It has pointed out some weaknesses in the present machinery for the settlement of industrial disputes like the *ad hoc* nature of machinery, the expense and delay involved in the procedure and the discretionary power of the Government in referring the disputes. Replacing the *ad hoc* machinery of the present, the Commission has recommended a permanent machinery in the shape of Industrial Relations Commissions at the National and State levels for settling industrial disputes. The National/State Industrial Relations Commissions (IRCs) would perform three main functions : (*a*) adjudication in industrial disputes, (*b*) conciliation, and (*c*) certification of trade unions as representative unions. For quick disposal of cases, there should be as many IRCs as are necessary. In addition to the IRCs, the Commission has suggested the establishment of Labour Courts for reviewing and interpreting all labour laws, awards and agreements.

CHAPTER 26

WAGE SYSTEMS

CONSIDERATIONS IN WAGE PAYMENTS

Wage is the price of labour, and like the price of other commodities, it is usually determined by the demand for and supply of labour. The demand for labour is linked up with the demand for goods and services. Other things remaining the same, the greater the demand for goods or services, the higher will be the demand for labour. The supply of labour is dependent upon the population of a country that is willing to work in business for the production of goods or services. From the standpoint of business, wages constitute an important item of the cost of production and are ultimately related to the productive capacity of labour. But unlike other factors of production, labour involves living human beings who must be supported by a subsistence wage. In between the upper limit of productivity and the lower limit of subsistence wage, actual wages are determined by a number of considerations.

Since wages are paid in advance of the sale of goods, the measurement of productivity becomes somewhat uncertain, and it gives rise to a conflict of interests between employees and employers. The bargaining powers of the parties have a strong influence on the fixation of actual wages. The bargaining strength, in turn, varies with the general economic conditions, the relative scarcity of labour, the degree of unionization and several other factors. Industrial history is replete with stoppages of work due to the payment of unfair wages. Wages must be fair so as to remove grievances and resentment on the part of workers. As pointed out by one writer, "wages operate both on the circumference and at the centre of industrial relations".[1]

Any scheme of wage payment must be based on the following four considerations :

Minimum wage—A minimum wage is such as would enable the average worker to maintain himself and his family in a reasonable state of health and efficiency. It should cover the normal needs of the general mass of employees for their living as members of a civilized society. In addition to the "saving wage" or subsistence wage necessary for the bare existence of human beings, it must provide for securing some amount of comfort, for educating the children of workers and for saving something that may carry the workers through their old age or

[1] Northcott, C. H., *Personnel Management: Its Scope and Practice.*

sickness. As the worker puts his best life into productive operations, the demand for a minimum wage arises from the right of labour to live by his work. Briefly, any wage level to be regarded as fair must look for the well-being of workers.

Guaranteed wage—Any scheme of wage payment must provide against abnormal conditions under which workers are prevented from earning a normal wage for no fault of their own. Under the system of remuneration based on work, breakdown in supplies or of machinery may force the workers to sit idle and to earn no wages. Justice demands that such situations are covered by a guarantee of certain minimum amount of weekly or daily income. Again, varying working conditions may result in different wages to different labourers for the same amount of efforts. For example, in coal mining, one seam may be easier to work than another ; in the factory, one operative may turn out a larger number of products with new machines as compared with another who handles old machines. For these varying circumstances, an equal piece rate leads to great injustice. Hence, the wage policy must guarantee the workers for a minimum earning during lay-off periods or abnormal conditions, and the guaranteed payments should be regarded as inevitable costs of the business.

Wage differentials—Wage rates between industries are required to be balanced suitably in view of the special requirements of training, skill and intelligence involved in the work. Barring this requirement, similar effort and skill should be rewarded equally in all industries. Any disparity in wage rate from the general level of wages brings serious discontent among the workers. Further, wage rates between men and women are also required to be fixed in an equitable manner. The concept of equality voiced in the demand of "equal pay for equal work" has been given up nowadays. The basic difference in the work between them is recognized because of the several limiting factors in the case of women operatives. Women workers have lesser physical strength and capacity for hard work ; they require greater training, supervision and welfare measures ; they are responsible for a high degree of labour turnover or absenteeism. In addition to these factors, women workers have the inherent weakness in matters of organizing trade unions.

Forms of wage payments—The form of wage payment must supply the greatest incentive to productivity, and it must reward extra efforts by extra payments. Where time rates are adopted, the gradation of different rates is required to be fixed with utmost care. In the case of piece rates, the establishment of rates by time and motion study should be done in a frank and open manner. Once established, the cutting of piece rates with a view to preventing high earnings is sure to destroy morale of the workers. An opportunity should always be given to the worker for earning a greater amount of wages wherever piece rates are intro-

duced. Incentive wage plans become successful provided they can be easily explained to the workers, the standard task can be attained by the exercise of reasonable efforts, and the plans are not revised without the consent of workers. As wage grievances are very serious and costly, a machinery should be set up for the redress of grievances by way of taking necessary corrective actions.

FORMS OF WAGE PAYMENTS

The various forms of wage payments fall into three general classes : (*a*) those based on the time worked—time wages ; (*b*) those based on the quantity produced—piece rates ; and (*c*) those which combine the features of both time wages and piece rate wages to work out different wage-incentive plans—premium and bonus plans. Incentive schemes differ from one another only in respect of their bases upon which payment is made. In the premium plans, the reward is made for reduction in the production time ; whereas in the bonus plan, the extra payment is made for an increased production. In all incentive plans, a standard time as well as a standard output is established ; and with reference to these standards, payments are made to the workers. Looked at from another aspect, incentive plans may be either individual incentive plans or group incentive plans. However, premium plans are more common than bonus plans.

Time Wages. Irrespective of the quantity produced by workers, time is made the basis of payment under this system. It is the oldest system of wage payment ; and even up to the present time, it is widely used as a form of remuneration. The greater mechanization of industrial operations and the increased strength of labour unions tend to make this form of wage payment more popular today than it was in the first quarter of this century.

Advantages—This form of wage payments has a number of advantages : (1) It gives the workers a remuneration which is more definite and certain as compared with other forms of payment. (2) Management can easily ascertain the total labour cost. The calculation of wages becomes very easy, and the number of hours put in by different workers is the only record to be maintained under this method. (3) Where the quality of products is more important than quantity, or the materials worked upon are very costly, time wages prove cheaper than piece rates in their ultimate results. (4) Time wages become the only equitable form of wage payment in those cases where labour productivity cannot be measured because of the non-standardized character of production. (5) In factories with assembly-line production, each operation is bound up with other operations, and a worker cannot work faster than the

group. Accordingly, time wages become the usual mode of payment rather than piece rates. (6) Labour unions perfer time wages, since this form of payment does not make any discrimination in wage matters between workers, and thereby it increases the strength of labour unions. (7) Because of the exercise of close supervision in small enterprises, time wages result in a cheaper form of wage payments.

Disadvantages—(1) The greatest disadvantage of this form is that it does not provide any incentive to greater efforts or harder work. It makes no difference between an efficient and a lazy worker, and both are treated on the same footing. (2) It leads to the reduced quantum of work unless a strict supervision is arranged. This method relies more upon the driving power of foremen in the plant for the purpose of obtaining a satisfactory output. (3) It destroys the morale of workers, and efficient workers are either driven out or their efficiency is pulled down to the level of inefficient workers. Competition between workers assumes a negative character and leads towards poor employee performances.

Piece Rates. As distinct from time, quantity of production is made the basis of payment under this method. Piece-rate wages are applicable to repetitive jobs and tasks which can be readily measured, inspected and counted. It is particularly suitable for the mass-production industries with standardized processes. It offers stimulus to skilled and efficient workers who can increase their earnings by their greater ability. It establishes individual identity, fosters initiative and creates enthusiasm in the minds of workers.

Advantages—(1) Under appropriate conditions, it excels other forms of payment in respect of economy as well as of justice. Remuneration being based upon the volume of production, there is a direct stimulus to increased production. (2) The cost of supervision becomes comparatively small because the workers tend to drive themselves in their own interests. (3) As the direct-labour cost per unit of production remains fixed and constant, calculations of costs for making tenders and estimates become easier. (4) The total unit cost of production also comes down with larger outputs, because the fixed overhead burden can be distributed over a greater number of units. (5) The working arrangements in constituting teams may be improved by the workers themselves to speed up work.

Disadvantages—(1) Too much emphasis on the quantity of production may lower the quality of products. To safeguard against this risk, a rigid inspection is required in those cases where piece rates operate. (2) The keeping of individual production records and the making of payrolls involve time and cost. (3) The establishment of piece rates is difficult and often becomes a source of grievances on the part of workers.

Without undertaking time and motion study and having past experience, piece rate may be set at so low a level that it exercises a demoralising effect on the workers. (4) In their eagerness for increased earnings, workers may exert themselves to the point of exhaustion so as to undermine their health and efficiency. (5) Forced stoppages of work may go to reduce the earnings of workers unless there is the provision for a guaranteed wage. (6) Differences in earnings cause dissatisfaction and resentment among workers. Trade unions are openly antagonistic to piece rates, as this form of wage payment encourages rivalry between workers and endangers solidarity of labour unions. (7) Excessive speeding up of work often results in careless handling of machines and equipments; and it adds to the cost of operations by the requirement of frequent replacements (8) Faulty production planning and control, intermittent orders and absence of other production facilities may prevent the workers from earning high wages through adequate work; and consequently, workers may adopt a hostile attitude towards management.

Modified Time and Piece Rates. There are several adaptations and modifications of these two basic rates. Of them, two forms deserve special mention, viz., (*a*) standard day-wage plan and (*b*) balance or debt plan. *Under the standard day-wage plan,* a standard wage for a standard performance is agreed upon by management and workers. If the workers fail to reach the standard, they are paid for the actual work completed on a piece-rate basis. On the other hand, if workers sit idle due to the fault of management, they must be paid for the idle time on a time basis. The responsibility for production is thus evenly shared between management and workers. *Under the balance or debt plan,* piece rates are adopted as the basis of payment subject to a minimum weekly time wage. When the worker on the piece-rate basis earns more than the time wage, he gets the entire amount of his earnings. On the other hand, if piece-rate wages fall short of the fixed time wage, the worker is given the stipulated weekly wage on condition that the difference in wages is to be made good out of future earnings. It amounts to a debt or advance made to the worker who is required to repay the amount.

INCENTIVE PLANS OF WAGE PAYMENTS

Incentive plans differ from the piece-rate system in that they require the establishment of a predetermined standard with reference to which payments are made. Moreover, the standard task is usually related to some time factors. Incentive plans incorporate all the advantages of piece-rate wages, and they resemble time wages in so far as the methods

of payment are concerned. They have benefited both the workers and employers, as they result in higher wages, lower labour turnover, and better industrial relations and morale. The following are the important incentive plans of wage payments :

1. **The Halsey Premium Plan.** This plan was devised by F. A. Halsey, a mechanical engineer. The plan calls for the payment of time wages to workers and gives them option to work on a premium basis. Hence, workers are assured of their basic day wages. For the purpose of premium, a standard time is set for each job on the basis of average past performances. When a worker can complete his job before the standard time, he is entitled to the premium under the scheme. The worker is paid the usual time rate for the actual time taken by him to complete the job. In addition, the worker gets a percentage (usually 50 per cent) of the wage payable for the time saved. Moreover, he can go in for some other jobs during the time saved by him.

The plan may be explained by an illustration. The standard time allotted for a job is 4 hours, the hourly rate is rupee one, and a worker completes the job in 2 hours. The worker can receive rupees two for the time worked plus a premium of rupee one for time saved. Moreover, he can go in for some other jobs during the time saved by him.

There are several advantages of the plan. By altering the percentage of premium, flexibility can be introduced in the plan. It guarantees the fixed time wage to slow workers, and at the same time, permits extra pay to efficient workers. Because of the percentage premium system, the piece-wise rate of pay gradually decreases with increased production. This results in reduced labour cost, although the worker is benefited by a higher wage. The plan is simple in design and easy to introduce. The incentive factor of the plan is realized without any possible resistance from workers, since it is optional and puts emphasis on the time saved rather than on increased production.

2. **The Rowan Premium Plan.** This plan was devised by James Rowan, a Glasgow manufacturer, and it is widely used in Great Britain. The Rowan Plan involves modification of the Halsey Plan which originated in the U.S.A. Like the Halsey Plan, it adopts a standard time for the performance of each job, guarantees fixed time wages and allows a premium for the completion of jobs before the standard time. But in respect of premium calculation, this plan differs from the Halsey Plan. Under this plan, premium consists of a percentage of wages for the time worked rather than for the time saved. For premium calculations, the percentage becomes equivalent to that proportion which the time saved bears to the standard time allotted. In other words, the time saved is expressed in percentage of the total time, and wages for the time worked

are increased by the given percentage to find out the premium money.

For example, if the standard time for a job is 8 hours, the fixed hourly rate rupee one and the actual time taken by a worker 6 hours, the worker would get a remuneration as follows :

Time worked 6 hours @ Re. 1 per hour	Rs. 6
(2 hours saved out of 8 hours, i.e. 25% of standard time)	
—Premium becomes 25% of wages for the time worked ..	Rs. 1.5
	Rs. 7.5

The Rowan system does not permit any change in the rate of premium and lacks the power of flexibility. Barring some benefit in the initial stages, the Rowan scheme aims at scaling down wages in contrast to the Halsey system which permits to earn high wages. Because of the limitation of earnings, the Rowan system does not provide incentive to high productivity. Moreover, the complex method of premium calculation is not intelligible to the common workers, and they cannot be expected to take much interest in the plan. Apart from these considerations, general merits and demerits of the Halsey Plan apply equally to it.

3. **The Taylor Differential Piece-rate Plan.** As a part of the scheme of scientific management, this plan was devised by Frederick W. Taylor with a view to providing greater incentives to efficient workers. Under this plan, a standard task is established by the techniques of time and motion study, and two piece rates are set up for each job. A high piece rate is allowed to those who can make equal to or higher than the standard performance ; and for others who cannot reach the standard, a lower piece rate exists. For example, if the standard task consists of 100 units, the lower piece rate is 5 paise per unit and the higher rate 6 paise per unit, a worker for any production below 100 units would get an amount equal to the number of units multiplied by 5 paise. For the production of units from 100 upwards, the remuneration would be given at the flat rate of 6 paise per unit.

The plan makes a wide discrimination between efficient and inefficient workers. The disadvantages of the plan far outweigh its advantages. It was never widely practised. Even after its modification through the introduction of three grades of rates under the *Merrick Multiple Piece-rate Plan*, the scheme is not accepted as a desirable form of wage payment at the present time.

4. **The Gantt Task and Bonus Plan.** H. L. Gantt, an associate of Taylor, devised this scheme on the basis of Taylor's plan. Under this scheme, fixed time rates are guaranteed. Output standards and time

standards are established for the performance of each job. Workers completing the standard job within the standard time or a shorter time receive wages for the standard time plus a bonus. The bonus is a percentage, varying from 20 to 50, of the wage for the standard time. When a worker fails to turn out the required quantity of products, he simply gets his time rate without any bonus. The two extreme points of the scheme are not well adjusted. Because of the guaranteed fixed time rate, labour costs become high in the case of a low volume of production. On the other hand, workers making standard performances get an abrupt rise in wages. Workers who approach near the standard are treated very unfavourably. That is, the scheme is preferred by the totally inefficient workers as well as by the most efficient workers. Reasonably efficient workers cut a sorry figure under the scheme.

5. **The Emerson Efficiency Bonus Plan.** In order to remove the defects and anomalies of the Gantt plan, this plan has been devised to give premiums to the workers who attain two-thirds of the standard task. Like the Gantt plan, it sets up a time standard and a task standard ; it also guarantees a fixed day wage. A premium, calculated on a sliding scale and rising up to 20 per cent of the pay for the time worked, is allowed under this method for any production over 66.7 per cent of the standard task. Commencing from a small percentage, the premium amounts to 10 per cent with 90% efficiency, and 20 per cent with the standard performance and over. Above the standard, workers are benefited by the pay for jobs undertaken during the time saved. It is a popular form of wage payment. A series of jobs over a period is taken into consideration in appraising the efficiency of workers.

6. **The Bedeaux Points Premium Plan.** Under this plan, a standard task is established for each job in terms of 'points'. Each minute of the allotted time for a task is called a point, and the value of each point is equivalent to the wage per minute. That is, both time and task are expressed through these points. As in other plans, it also guarantees basic hourly rate. Any production over 60 points calls for a premium. The premium is equal to the excess points produced within an hour over the marginal level of 60 points. For example, if a worker produces 90 points per hour, he would get the hourly rate plus a premium money for 30 points which come to half of the hourly rate. Workers failing to reach the standard of 60 points per hour are shifted to other jobs. The plan is simple in design and has become very effective in its application. Workers get higher wages, management secures reduced production cost, and the plant morale is maintained satisfactorily.

SUPPLEMENTARY INCENTIVE PLANS

Since wages are the best incentive to productivity, various plans have been devised to stimulate the interests of labour for deriving satisfactory performances. In addition to the regular and basic forms of wage payment, these plans are intended to make extra payments on the attainment of certain expected results. Some important plans under this group may be stated as follows :

Collective or group bonus—Instead of giving bonuses to individual workers, this bonus is made payable to all the workers on a collective basis. This bonus is promised by management in advance of the commencement of work for securing an effective teamwork and is made payable upon the overall results. Besides increased production, collective bonus may call for an improvement in the quality of products, a better maintenance of equipments or for several other purposes. In all cases, a fixed standard of performance is established, and the bonus is given for the results shown over the standard performance. For example, if there is 10 per cent excess production over a certain standard of performance, workers of the plant collectively may get a bonus of 10% of the surplus income.

Ad hoc production bonus—In contrast to the group incentive bonus, this bonus is not paid regularly and is not announced in advance. An arbitrary amount is usually given as bonus according to the unilateral decision of management. Workers cannot claim this bonus as a matter of right, and they cannot expect the bonus regularly, whatever may be the working results of the concern. In other respects, this bonus is akin to the group incentive bonus. But because of the uncertainty of awards and of their amounts, production bonuses fail as incentive devices ; they are too vague and remote to stimulate workers' interest. However, they may create a better relationship between labour and management and may secure the loyalty of workers to some extent. This production bonus has become common nowadays in our country. For its closeness with profit sharing, this scheme is also referred to as profit bonus.

Sliding scale—In order to maintain the existing standard of living during periods of rising prices, or to give a share in the increased prosperity of the enterprise, basic wage rates of the workers may be made to vary with the cost of living index or with the selling price of the company's products. The base index or the base price is fixed beforehand, and the scale of variations from the standard is also determined by labour and management in their mutual agreements. Along with changes in the index or in the price, wages are automatically and peacefully adjusted by the sliding scale. The plan involves one great difficulty. Workers cheerfully accept upward revision of wages, but they are not

agreeable to accept any cut in wages as required by downward movement in the cost of living index or in the selling price of products.

Profit sharing—Profit sharing has been defined "as any procedure under which an employer pays to all employees, in addition to good rates of regular pay, special, current or deferred sums, based not only upon individual or group performance, but on the prosperity of the business as a whole" (*The Council of Profit Sharing Industries in U.S.A*). Profit sharing schemes are designed for enlisting full employee co-operation and support, for motivating the workers towards peak performances, and for securing good industrial relations and high plant morale. As incentives to greater productivity, profit sharing schemes are introduced by the voluntary agreement between labour and management along with the basis of profit sharing beforehand. In some countries like New Zealand, Brazil, Chile, etc., the introduction of profit sharing is obligatory on the part of employers. In advanced countries like the U.K. and the U.S.A., voluntary schemes of profit sharing are in operation in a number of enterprises. In India, some well-established concerns have introduced profit sharing schemes on a voluntary basis, e.g. the Tata Iron & Steel Co., Ltd., the Indian Iron & Steel Co., Ltd., the Tinplate Co. of India, Ltd. etc.

PROFIT SHARING AND CO-PARTNERSHIP

Profit sharing calls for giving to employees, in addition to their regular wages, an agreed share in the profits of the concern over a period as per mutual negotiations between labour and management. Profit is shared in those cases where the amount is sufficient for the purpose, and employees are never asked to share losses. Important features of profit sharing may be stated as follows : (*a*) The scheme must provide for the benefit of all employees in the business, particularly the operative personnel. The executive personnel may or may not be included under the scheme. (*b*) Profit sharing involves payments in excess of the regular and adequate wages. Profit sharing amounts to deferred wages payments when wages rates are kept at reduced levels. (*c*) Profit sharing, as the name implies, must involve an appropriation of the net profit of the business. After the payment of a certain minimum dividend to shareholders, workers must have the right to participate in the distribution of net profits. (*d*) Profit is an uncertain matter, and a share thereof cannot be assured by management in advance in quantitative terms. However, the basis of profit sharing through the fixation of percentages and the plan itself with other particulars are required to be settled by negotiations between labour and management. Profit sharing introduced by the unilateral action of management results in a production bonus, not a scheme of profit sharing. (*e*) Profits are dis-

tributed in the current year by way of yearly or half-yearly payments. Alternative method of distribution involves payments into provident funds or deposit accounts. Like the interim dividend, profits may be paid within the year ; but the payment at the end of the accounting year is the most common method. As opposed to deferred payment, workers insist upon current payments.

Profit-sharing schemes do not interfere with other incentive plans, whether individual or group incentives. On the contrary, other plans are supported and strengthened by profit sharing, as distribution of profit is made according to the proportion of wage earnings under the basic plans. After the creation of necessary reserves and the payment of a fixed percentage of dividend from net profits, the balance of profit is distributed between capital and labour in the agreed ratio. Depending upon the rate of capital investment per worker, workers' share of profit may vary from 30 to 50% of the balance profit.

Merits and demerits of the scheme—The profit-sharing scheme has been designed to integrate the interest of employees with that of employers and to develop co-operation and loyalty among workers. The philosophy of profit sharing rests upon the recognition of workers as distinct industrial citizens and upon the intention of enlisting workers' faith in the private enterprise. In order to reduce industrial disputes and frictions to the minimum which centre round the questions of profits, workers are allowed to have a share in the increased prosperity of the business. Because of their share in the profits, workers attempt at making the size of that profit as large as possible through various ways, viz., greater productivity, lesser supervision costs, more careful handling of machines and materials, and better quality production. It acts as a morale builder by reducing labour turnover, absenteeism or strikes and by increasing collaboration, loyalty or efficiency.

As against these merits, there are several drawbacks of the plan. The universal failure of most of the schemes suggests some inherent limitations of profit-sharing plans. Limitations include (1) lack of incentive on the part of workers, (2) uncertainty of profits despite strenuous efforts, (3) unsatisfactory results obtained by the company from the plan, and (4) hostile attitude of labour unions. Profit-sharing payments are too uncertain and delayed to arouse workers' interest and initiative in the day-to-day jobs. The incentive value of the plan is of doubtful character. The cost of production and along with it, the profits of a business are dependent on a large number of factors, both within and outside the business concern. In spite of their best efforts, workers may find at the end of the year that there exists no profit to be shared by them. Moreover, workers are to rely upon management for the accuracy of calculations. Many companies were forced to abandon the schemes for their disappointing results. The profit was not increased appreciably ;

they destroyed the discipline and morale of workers in cases of no profits ; and the workers became distrustful of management. Labour unions oppose the scheme for causing isolation of workers from the unions and destroying labour solidarity.

Critical appraisal—The two basic objects of profit sharing are increased productivity and better industrial relations. Profit-sharing schemes have failed to realize both the objectives for which they are designed. Because of the uncertainty, delay and small amounts involved in payments, they cannot stimulate workers to greater activity. Workers take an indifferent attitude towards the plan and suspect it to be a cunningly devised measure to speed up work. As a supplementary source of earning, it cannot establish good industrial relations. The amount of earnings is only one contributory factor of industrial relations and such relations depend on several other factors, particularly social and personal. On the contrary, profit-sharing schemes may go against industrial relations when they cannot bring profits to the workers at the completion of the year. Workers sense a feeling of deception and develop a state of mind that is not at all conducive to amicable relations. Labour unions do not fail to utilize the situation in their favour, and they explain to workers the ulterior motive of management in introducing the scheme. Labour leaders are looked upon as more trusted persons than the business executives by workers. Consequently, it is commonly suggested that the profit-sharing plan should be scrapped outright, and the small amount distributed as the share of profit should be given by way of higher wages for securing better results.

Co-partnership. Co-partnership is an extreme form of profit-sharing plan in which workers are allowed to have a voice in managing the business. In addition to the sharing of profits, this scheme calls for the workers' participation in the assumption of authority and responsibility over the enterprise. Three features of the plan are : (1) receipt of some share in the net profits of the business over the basic wage rate ; (2) investment of the workers' entire share of profits or a part thereof in the capital resources of the business ; and (3) assumption of some control over the working of the enterprise either through the acquisition of shareholders' rights or through the formation of a co-partnership committee, composed of the representatives of employers and employees. Shares are usually offered at a concessional rate, and a fixed limit is placed up to which each worker can acquire these shares.

Several experiments with the profit-sharing plan indicate that the scheme can only become successful when co-partnership feature is tagged to it. Whatever may be the form of profit-sharing, whether with or without co-partnership, success of the scheme rests on the progressive outlook of management and the enlightened personnel policies. There

is no special strength of these plans so that they can stand on their legs, irrespective of the support of management. Co-partnership, being a modified form of profit-sharing plan, is subject to the same advantages and disadvantages. Workers' control over the enterprise exists in name only and has no real significance. It is ridiculous on the part of workers to expect a real control over the enterprise in the capitalistic economy. If an effective control is assumed, the enterprise becomes transformed into a co-operative organization in which profit motive, however, is to be abandoned.

WAGE POLICY AND WAGE LEGISLATION

On the recommendations of the Planning Commission, the Government has accepted the guiding principle of reducing disparities in income and allowing workers to have their due shares in the national income. With this end in view, the Government has decided to maintain the wage differences between jobs at the minimum possible level, as required by variations in skill, training, experience and attendant risks. To improve matters on wages, a minimum wage law has already been enforced, and views on profit sharing and fair wages have been ascertained by the appointment of two committees.

The Minimum Wages Act, 1948. The Act provides for the fixation of minimum rates of wages and their revisions from time to time with regard to employees in certain specified industries. Some 12 industries like plantation, tobacco manufacturing, bidi making, rice, flour and dal milling, etc. have been brought under the scope of the Act : and other industries may be added by the Government to this list. The Act provides for the establishment of different State Advisory Boards and a Central Advisory Board to make necessary enquiries for fixing minimum wages. The Central Board is also required to co-ordinate the activities of various State Boards. An all-India minimum wage rising up to Rs. 100 per month has been recommended by the Tripartite Labour Conference in 1960 as the coveted ideal. Most of the State Governments have fixed minimum wages relating to the industries enumerated in Part A of the Schedule to the Act, and some State Governments have extended the scope of the Act to other industries. The measure can be criticized in several ways. The Act is confined to a comparatively small number of industries and several other industries where "sweated" labour exists, have been excluded from the purview of the Act. Secondly, the Act is not being properly administered owing to the absence of a special machinery. Thirdly, the concept of the minimum wage has not been properly elaborated. Strictly speaking, the Act calls for the establishment of the "saving wage" at the subsistence level, and not the "minimum

wage" at the health and efficiency level. To effect improvement in administration and enforcement of the Minimum Wages Act, 1948, the Government of India appointed a one-man committee in 1965 for recommending suggestions.

The Fair Wages Committee. On the Report of the Fair Wages Committee, a Fair Wages Bill was presented before the Parliament in 1950, but it was not passed into an Act. The Fair Wages Committee was of the view that fair wage should be fixed at such a level between minimum wage and living wage as it becomes conducive to the adoption of the desirable goal of living wage ultimately and recommended that the "minimum wage should represent the lower limit of the fair wage, the upper limit being the capacity of industry to pay." In between these two limits, the Committee suggested that fair wage should depend upon (*i*) labour productivity, (*ii*) prevailing rates in the same or comparable occupations and trades in the locality, (*iii*) level of the national income and its distribution, and (*iv*) the industry's place in the national economy.

The Profit Sharing Committee. The Profit Sharing Committee submitted its Report in September 1948 with certain recommendations, but the recommendations have not been given effect as yet. The Committee suggested that profit sharing may be introduced as an experimental measure for a period of five years in six important industries, viz., cotton textiles, jute, steel, cement, cigarette making, and manufacture of tyres. An outline of the scheme was drawn up by the Committee. After providing for necessary reserve (10% of net profits) and a fair return on capital, 50% of the surplus profits of the concern should be given to workers. The Committee was of the view that 6 per cent return on paid-up capital plus free reserves would be a fair return on capital investments under existing conditions. The individual worker's share of profit should be in proportion to his total earnings during the preceding 12 months, as reduced by dearness allowances and other bonuses. Where the worker's share of profits exceeds 25% of his basic wage, the cash payment may be limited to 25% of the basic wage, and the balance amount of profit may be held back in his provident fund or deposit account. The Committee further suggested that profit sharing should be introduced in those six industries on the basis of each separate unit so that direct interests and loyalty of the workers can be aroused. As an experimental measure, the Committee pointed out, profit sharing might be introduced on an industry-cum-locality basis in the textile industry at the Bombay, Ahmedabad and Sholapur centres.

Compensation for Lay-off and Retrenchment. The Industrial

Disputes Act of 1947 as amended in 1953 provides for the payment of compensation to workers who are laid off or retrenched by an industrial undertaking. The term "lay-off" implies forced idleness on the part of regular workers whose names appear on the muster rolls of the establishment. Forced idleness may arise from a number of causes like shortages in the supply of coal, power and materials, breakdown of machines and equipment, defective production planning, accumulations of stocks, etc. The term "retrenchment" means termination of employee services for any reason other than dismissal by way of disciplinary action. This compensation is payable to all workers who have completed continuous service of one year in industrial concerns employing fifty or more workers.

For lay-off purposes, the compensation is equivalent to fifty per cent of basic wages plus dearness allowances for the total lay-off period with subject to a maximum of 45 days. Additional compensation over these 45 days during twelve consecutive months is allowed in those cases where lay-off is prolonged, after the first 45 days, for a continuous period of one week or more. By this measure, the Act requires the payment of a guaranteed wage for the lost time. As regards retrenchment, the amount of compensation should be equivalent to 15 days' average pay for every completed year of service together with one month's prior notice of retrenchment or the payment of wages for the notice period.

The Industrial Disputes Act of 1947 was further amended in 1965 and this amending Act was brought into force from December 1, 1965. The Act provided for (*a*) extending the definition of industrial dispute so as to include cases of all discharges and dismissals, (*b*) imposition of a penalty for non-implementation of awards and settlements, and (*c*) payment of lay-off compensation for all days after the expiry of first 45 days.

The Payment of Wages Act, 1936. For ensuring regular payment of wages to workers and for preventing unauthorized deduction from wages, this Act has been passed in 1936 largely on the recommendations of the Royal Commission on Labour in India. According to the provisions of the Act, wages should be paid on or before the tenth day of every month, and no deductions, except those mentioned in the Act, can be made by employers in paying wages. Delay in the payment of wages or withholding the payment of wages is strictly prohibited under the Act. The provisions of the Act have become outdated to some extent, because no important changes have been made since 1936. Workers whose wages are less than Rs. 400 per month (raised from Rs. 200 by an amendment in 1957) come under the operation of the Act. However, some of the proposed amendments to the Act which are under the active consideration of the Government include (*a*) extension of the

wage protection to employees in air services, tramway services and motor transport services in addition to railway employees and factory workers, (*b*) deduction of premia in respect of fidelity guarantee insurance, (*c*) enhancement of time limit for presenting claims and (*d*) imposition of greater penalty for violating the provisions of the Act.

Wage Boards. For settling disputes in wage matters and fixing wages in different industries, tripartite wage boards consisting of equal representatives of employers and workers and an independent chairman, have been constituted. Recommendations of the wage boards for cotton, textile, cement and sugar industries have already been implemented. On the demand for constituting wage boards for plantations, jute, iron and steel, coal and other industries, several wage boards have since been established. The total number of wage boards functioning at the end of March 1968 was twenty. The constitution of a National Wage Board has become an urgent necessity for co-ordinating the activities of different wage boards and for undertaking an extensive survey of region-wise and industry-wise wages with a view to evolving broad principles of wage fixation.

The National Commission on Labour (1969) has made certain recommendations for improving the working of wage boards. (*a*) There should be no independent persons as members of the wage board and the chairman should be appointed by the common consent of the parties. (*b*) The wage boards should submit their recommendations within one year of their appointment and such recommendations should remain in force for a period of five years. (*c*) Unanimous recommendations should be made statutorily binding. (*d*) A Central Wage Board Division should be set up on a permanent basis to provide necessary advice and service to all wage boards. In respect of wage policy, an Expert Committee appointed by the Planning Commission has urged in 1972 the evolution of a national wage policy for ensuring to the worker a minimum consumption along with a definite share in the growth and profits of industrial concerns. The Committee has also proposed the immediate creation of a National Wage Board.

Bonus Commission and the Bonus Act. The Bonus Commission was appointed in December 1961 under the chairmanship of Mr. M. R. Meher and report of the Commission was submitted to the Government in January 1964 for consideration. Defining bonus as a share of the workers in the prosperity of the concern in which they are employed, the Commission has laid down a formula for determining the amount of bonus from total profits after providing for depreciation, income tax and super tax, seven per cent return on paid-up capital and four per cent return on reserves. Sixty per cent of the available surplus would be

earmarked for payment of bonus to workers or employees drawing a total basic pay and dearness allowance taken together up to Rs. 1,600 per month. The balance forty per cent of the available surplus would be utilized for gratuity and other necessary reserves, rehabilitation requirements, payment of super profits tax as well as bonus payments to supervisory staff drawing over Rs. 1,600 per month, if desired by the concern. The minimum limit for bonus payment to workers who have worked throughout the year is either four per cent of their annual earnings or Rs. 40, whichever is higher. The maximum limit has been fixed at 20 per cent of their annual earnings by way of basic wages and dearness allowances. If the available surplus exceeds the maximum limit or falls below the minimum limit in any year, such amount is to be set on or set off in the succeeding four years. This formula for bonus payment is to be applied to private sector industries and some public sector industries. The Commission has pointed out that the payment of bonus should not be delayed by later than eight months after the close of the year. New concerns have been exempted from making bonus payment up to a period of six years. Although employees drawing up to Rs. 1,600 per month are entitled to bonus, the quantum of their bonus would be limited to what it would be if their pay and D.A. were only Rs. 750 per month. An employee who has worked for less than a year would get *pro rata* bonus.

To give effect to the recommendations of the Bonus Commission, the Bonus Act was passed in September 1965. It provides for the payment of a minimum bonus to each worker who has worked throughout the year at the rate of either 4 per cent of his total basic wage and dearness allowance paid to him during the year or Rs. 40, whichever is higher. But the validity of several provisions of the Act was challenged in the Supreme Court by employers and the controversy was kept unresolved for a period. Towards the beginning of 1969, the Government of India issued an Ordinance to plug the loopholes of the Act. The Payment of Bonus Act, 1965 was amended in 1973-74 providing for a higher minimum bonus of $8^1/_3$ per cent from any accounting year commencing from 1972.

CHAPTER 27

EMPLOYEE WELFARE AND LABOUR LEGISLATION

WELFARE ACTIVITIES

Welfare activities take many and varied shapes in different countries according to the nations' economic position and political belief. Welfare activities fall into two groups—intra-mural, i.e. within the plant and extra-mural, i.e. outside the plant. Within the plant, welfare activities centre round matters of working conditions like hygiene, health, comfort, ventilation, lighting, cleanliness, washing, safety, first aid, rest room, creches and canteen facilities. Outside the plant, welfare activities include housing accommodation, education, library, reading room, club room and recreation centres, sports and games, medical advice, pensions and provident funds, sickness and maternity benefits and the like.

In the pre-independence days, welfare activities were narrow in scope and limited in application. Barring some large-sized undertakings, welfare activities were not adopted in the majority of industrial enterprises. After independence, the national Government has extended the scope and application of welfare activities by a series of legislative enactments. The factory legislation, the mining legislation and the social security legislation bear testimony to the efforts of the State in extending the frontier of welfare measures in several ways. Besides, for providing the workers with better housing accommodation, an all-out effort is being made by the State through the establishment of Housing Boards and the adoption of the Subsidized Industrial Housing Scheme. A large number of multipurpose welfare centres has been set up by the State Governments for developing the body and mind of the workers.

The object of welfare activities is to ensure a happy and contented living on the part of workers. This enlightened social living develops employee morale which, in turn, paves the way towards good industrial relations, increased productivity and greater national prosperity. The initiative of the Government in pushing the horizons of welfare measures can be found in two motives. *First*, with the avowed ends of establishing a Welfare State, the Government cannot remain a mere onlooker in matters of labour welfare. Labour as a class constitutes a sizeable part of the community. Leaving aside the questions of labour welfare, the concept of the Welfare State becomes somewhat distorted. *Secondly*, industrial progress and productivity are circumscribed by the willing support and good morale of workers. For triggering human energy to its full capacity, there is no alternative but to arrange for welfare activities.

Government initiative has become particularly necessary for a country where management is confused with domination by many industrialists and welfare activities are considered redundant.

Welfare measures through legislative prescriptions come into actual operation provided the statutes are rigidly enforced and industrialists are made to develop a co-operative attitude. Much leeway is to be made in both the spheres for securing the full benefits of the prescribed welfare measures. Even when the welfare activities are adopted in full, the success of such measures is dependent upon three conditions. *First,* welfare activities must be sought after by the workers rather than imposed by the unilateral action of management or the State. Welfare activities must be conducive to the general level of education and taste of workers without curtailing their freedom of action in any way. *Secondly,* welfare activities are no substitute for good and adequate wages. For the extension of welfare activities, if wages are kept at a lower level, such beneficial activities would destroy employee morale rather than developing morale. *Thirdly,* welfare activities must be supported by adequate human relations work, otherwise they fail to achieve the purpose for which they are designed.

LABOUR LEGISLATION

In matters of labour legislation, findings of the Royal Commission on Labour in India and the Labour Investigation Committee have made important contributions. The Royal Commission on Labour was appointed in 1929 and the report of the Commission was published in 1931. On the recommendations of the Royal Commission, a series of labour legislation was made in the thirties of this century. The Labour Investigation Committee was appointed under the chairmanship of Shri D. V. Rege to make recommendations on matters like wages, employment, social conditions and housing. And the report of the Rege Committee was published in 1946. The scope of labour legislation was extended significantly in the years following to give effect to the recommendations of the Committee. Since Independence profound changes have taken place in the industrial sphere in India and several defects of the existing labour legislation have been revealed. With a view to adopting a sound national labour policy in the changed situation, the Government of India appointed in December 1966 a National Commission on Labour under the chairmanship of Shri P. B. Gajendragadkar to review changes in the condition of labour since Independence and to report on measures for protecting the interest of labour. The Commission submitted its report in 1969.

Of the different types of labour legislation, industrial disputes legislation, trade unions legislation and wage legislation have been discussed

in the previous two Chapters. Other important legislations like factory legislation, mining legislation, plantation legislation and social security legislation have been discussed in the present context, because all of them have provided for welfare measures in some form or other. In framing these pieces of legislation, the four cardinal principles of labour legislation, viz., social justice, social advancement, national economy and international uniformity have been taken into account. While international uniformity has been achieved through the good office and advice of the International Labour Organization (I.L.O), benefits of social advancement as revealed by the subsequent march of events, are given to labour by the rule-making powers of the Government.

Factory Legislation. The Factories Act of 1881 was the first piece of factory legislation meant for protecting children and providing some health and safety measures. After being amended several times, the Act of 1881 was overhauled and replaced by the Factories Act, 1934. Again, the Act of 1934 had to undergo several amendments up to the year 1948 when a new Act was passed for consolidating the old measures and enlarging the scope of factory legislation in several ways. The Factories Act, 1948 which came into force from 1st April, 1949, remains operative up to the present time. Some minor amendments to the Act have been effected in 1949, 1950, 1953 and 1954. There were some proposals for amending the Act in 1966 with a view to plugging loopholes and strengthening of safety measures. The Act is administered by State Governments and they are empowered to make rules for the purpose. For clarity of understanding, the provisions of the Act may be studied under the following heads :

1. *Application of the law*—The Act applies to all factories using power and employing 10 or more workers as well as to factories run without the use of power by employing 20 or more workers. The old distinction between seasonal and perennial factories is removed by the Act which applies everywhere with equal force.
2. *Age of employment*—The minimum age for employment of a child has been raised from twelve to the completion of the fourteenth year. Children completing their fourteenth year of age and adolescents completing their fifteenth year of age but not completing their eighteenth year of age cannot be employed unless they are medically certified to be fit. Certificates of fitness are to be renewed annually and shown by the young persons at the time of their work.
3. *Hours of work*—The Act provides for 48 hours of work per week and 9 hours of work per day in the case of adult workers who have completed their eighteenth year of age. There should be a weekly holiday, and no worker can be made to labour for

10 full days at a stretch without having a holiday. Recess for half an hour must be allowed after five hours' continuous work. The maximum hours of work on a particular day may be extended up to 10 hours and a half including the rest interval. Overtime work is permissible on such conditions that wages for overtime work are paid at double the rate and that total overtime work does not exceed 50 hours during any quarter. For children and adolescents, the working day has been fixed at 4 hours and a half including the rest interval for half an hour. The employment of women and children during the night (from 7 p.m. to 6 a.m.) is strictly prohibited.

4. *Safety and protection*—Children and women cannot be employed in occupations which are deemed dangerous. For providing safety against dangerous and moving parts of machinery, the Act requires the factory owners to make suitable arrangements for fencing, covering or guarding the machinery. Safety devices are to be supplied to workers and remedial measures are to be brought within their knowledge for protecting them against fire, dangerous fumes, inflammable materials and occupational diseases.
5. *Health, hygiene and environment*—There must be adequate arrangements for cleanliness, disposal of wastes and effluents, ventilation, cooling, drinking water and latrines in all factories. The Act calls for keeping first-aid equipment under the charge of a properly trained person on the part of all factories. For large factories, there should be one separate first-aid box for every one hundred and fifty workers. Furthermore, maintenance of an ambulance room under the charge of medical and nursing staff is obligatory for all factories employing more than 500 workers. Plans and specifications of factory buildings are required to be approved by the Factories Inspectorate. New factory buildings are supposed to provide a certain minimum space for each worker within the plant.
6. *Welfare measures*—After the completion of one year's continuous service, adults are entitled to one day's leave with wages for every 20 days of work and children to one day's leave with wages for every 15 days of work. Leave can be accumulated up to 30 days in the case of adults and 40 days in the case of children. Factories employing 500 or more workers are required to appoint one properly trained Labour Welfare Officer. Canteens are to be set up in those factories which employ 250 or more workers. In addition, creches are compulsory for factories which employ more than 50 women workers. Besides, there must be washing and rest room facilities in all cases.

The State Governments can extend these welfare measures by their rule-making powers.

The Industrial Employment (Standing Orders) Act, 1946—The Act calls for the framing of standard conditions of employment and the certification of such conditions by the Certifying Officer. The failure of industrial enterprises to develop rules for the guidance of employees and to communicate their terms of employment has led the Central Government to pass this Act in 1946 for mitigating industrial disputes and maintaining discipline. The Act used to apply to all concerns employing one hundred or more persons in a wide range of industries. By an amendment in 1961, the coverage of the Act has been extended to establishments employing even less than 100 persons. The Act covers all manual, clerical, supervisory and technical workers who earn not more than Rs. 500 per month. To the list of Model Standing Orders and Rules made by the Central Government in 1946, some additions have been made by the State Governments which are empowered to administer the law and to make necessary rules thereof. Accordingly, there is a lack of uniformity in rules pertaining to conditions of employment.

Model Standing Orders have been designed by incorporating some provisions of the Factories Act and the Payment of Wages Act and include matters like (1) classification of workmen as to permanent, temporary and casual workers, *budlies,* probationers and apprentices; (2) periods and hours of work, holidays, pay days and wage rates; (3) shift work and attendance; (4) leave rules and procedures; (5) temporary stoppages of work and closing of work; (6) retrenchment, suspension, dismissal and misconduct; and (7) means of redress against unfair treatment or wrongful exactions. Employers are required to draft standing orders covering all matters contained in Model Standing Orders and to submit them for certification to the Certifying Officer who is usually the Labour Commissioner. The Amending Act of 1956 permits the Certifying Officer to decide upon fairness or reasonableness of standing orders. Another amendment empowers both the employers and the workers to apply to the Certifying Officer for modifications of standing orders.

Mining Legislation. After enacting the two Mines Acts in 1901 and 1923, the present Indian Mines Act was passed in 1952 to bring the legislative measures in line with the Factories Act, 1948. The Indian Mines Act, 1952 applies to all varieties of mines including work centres run for the maintenance of machines and equipments on the part of such mines. It fixes the working period for all workers, whether surface or underground, at 48 hours per week, at 9 hours per day in the case of surface work, and at 8 hours per day in the case of underground work. Women and adolescents cannot be employed in under-

ground work, and the employment of women is confined during day time between the hours of 6 a.m. and 7 p.m. For adolescents, the hours of work have been limited to 4 hours and a half per day above ground ; also adolescents who have not completed their eighteenth year of age and who have not obtained a fitness certificate from a certifying surgeon are prevented from being engaged in any underground work. Overtime rates have been prescribed at 1½ times the normal rate for surface workers and at twice the ordinary rate for underground workers. Annual leaves with pay at the rate of 14 days for monthly paid workers and 7 days for weekly paid workers are to be extended to all employees who have completed one year's service. The Act requires the provision of welfare facilities at work sites and calls for the appointment of welfare officers in appropriate cases.

Concerning coal mines, there are additional enactments like the Coal Mines (Conservation and Safety) Act of 1952, the Coal Mines Labour Welfare Fund Act of 1947, and the Coal Mines Provident Fund and Bonus Schemes Act of 1948. Under the Coal Mines (Conservation and Safety) Act of 1952, conservation of coal and provision of safety measures are entrusted to a Coal Board established for the purpose. For giving benefit to more than three-fourths of total miners of the country engaged in coal mines, the Coal Mines Labour Welfare Fund Act of 1947 provides for welfare measures by way of housing, transport, recreation, washing, educational and medical facilities. Separate hospitals and maternity centres are included under medical facilities for colliery workers. To finance these welfare activities, the Government is empowered under the Act to levy a cess on coal output for the building up of a Welfare Fund. All welfare measures are financed from the Fund and the Fund is administered by the Government with the assistance of an advisory committee composed of equal representatives of mine owners and workers thereof. (The Coal Mines Provident Fund and Bonus Schemes Act of 1948 has been discussed in the context of social security legislation).

Plantation Legislation. The Tea District Emigrant Labour Act has been passed in 1932 to regulate the recruitment of labour for Assam tea gardens and the Act remains in force even now. For regulating working conditions of plantation workers and ensuring their welfare, the Plantations Labour Act has been passed in 1951, and it applies to tea, coffee, rubber and cinchona plantations at the present time. Because of the slump in the tea industry, the implementation of the Act was held in abeyance up to 1st April 1954 when it was brought into force. The Act fixes the working period at 54 hours per week for adults and at 40 hours per week for adolescents and children ; it prohibits night work between 7 p.m. and 6 a.m. in the case of women and children and

restricts the employment of children below the age of 12 years. Young persons who have not completed their eighteenth year of age require medical examination and fitness certificates thereof for employment purposes. Adults are entitled to one day's leave with wages for every 20 days of work and young persons to one day's leave for every 15 days of work. As regards medical and welfare facilities, the provisions of the Act are identical with those of the Factories Act, 1948. Provision of housing accommodation is a special obligation of garden owners. To enhance the applicability of the law, the Plantations Labour Act has been amended in 1961.

Social Security Legislation. Starting from a modest beginning through the framing of the Workmen's Compensation Act of 1923, the social security legislation encompasses today other enactments like the Employees' State Insurance Act of 1948, different Maternity Benefit Acts of State Governments, the Coal Mines Provident Fund and Bonus Schemes Act of 1948, and the Employees' Provident Fund Act of 1952. To the list of social security legislation, compensation for lay-off and retrenchment, as introduced by the Industrial Disputes (Amendment) Act of 1953, may be added. As this compensation has been dealt with in Chapter 26, social security measures centring round the following five enactments are discussed here.

1. *The Workmen's Compensation Act,* 1923—At the present time, the Act applies to workers who earn not more than Rs. 500 per month (raised from Rs. 400 in 1962-63) and who are employed in more than thirty hazardous occupations and industries including factories, mines and railways otherwise than in a clerical capacity. The Act provides for the payment of compensation for injury caused either by industrial accidents or by occupational diseases in the course of employment and resulting in death, permanent total disablement, permanent partial disablement as well as in temporary disablement. Workers are not entitled to compensation in those cases where the incapacity does not last for more than three days (reduced from 7 days in 1959) or where the injury is caused by the fault of the workman. According to the nature of the injury, amount of compensation is based upon the average monthly wages of the affected worker. For death of adult workers, the amount of compensation ranges from Rs. 500 to Rs. 4,500, and for permanent total disablement, it varies from Rs. 700 to 6,300. In the case of permanent disablement or death, the compensation is paid in a lump sum; and in other cases, fortnightly payments of 50 per cent wage are made from the fourth day of disablement.

2. *Maternity Benefit Act*—The Bombay Government took the lead in passing the Maternity Benefit Act in 1929, and other States followed Bombay in framing such legislation. In subsequent years, almost all the

States enacted Maternity Benefit Acts in their own jurisdiction. For the benefit of women miners and planters, the Central Government also passed the Mines Maternity Benefit Act, 1941 and the Plantations Labour Act, 1951. Maternity Benefit Acts were superseded in perennial factories by the Employees' State Insurance Act of 1948, and as such, these Acts used to apply to all establishments except perennial factories. These Acts provided for compulsory rest period on the part of women workers before and after child birth and for payment of cash benefits during the period. There was a lack of uniformity in the provisions of these different State Acts. To introduce uniformity in the provisions of Maternity Benefit Acts pertaining to seasonal factories, mines and plantations, a Maternity Benefit Act was passed in 1961.

3. *The Employees' State Insurance Act*, 1948—The Act is the first attempt in India for introducing a broad-based scheme of health, maternity and accident insurance. The Act applies to all employees including the clerical staff who are employed in perennial factories employing 20 or more persons and using power, and who earn not more than Rs. 500 (raised from Rs. 400 in 1966) per month. The Act may be extended by the State Governments, in consultation with the Employees' State Insurance Corporation and with the approval of the Central Government, to other establishments like commercial, industrial or agricultural ones. The Act extends to the whole of India except the State of Jammu and Kashmir. The Act was first put into operation in Kanpur and Delhi in 1952 and was extended to other centres in course of time.

It provides for five types of benefits, viz., sickness benefits, maternity benefits, disablement benefits, dependants' benefits and medical benefits. (*a*) For sickness, cash benefits are given for a maximum period of 56 days in a year at the rate of fifty per cent of the average daily wages. In special cases of sickness like tuberculosis, sickness benefits at a reduced rate are extended up to a period of one year, provided the worker has completed two years' continuous service in the concern. (*b*) Maternity benefits are granted for 12 weeks, of which not more than 6 weeks should precede the expected date of confinement, at the rate of 75 paise per day during the period. (*c*) Disablement benefits vary according to the nature of injury. For temporary disablement, workers are entitled to half of their wages for the period of disability. For permanent total disablement, a life pension equivalent to about half of the employees' wages is given, and in the case of permanent partial disablement, a proportionate life pension is granted. (*d*) Dependants' benefits are given to the dependants of the deceased worker in case of death caused by the employment injury. Dependants' benefits take the form of half wage pension for the well-being of widow, sons or daughters of the deceased. (*e*) Medical benefits are given by way of medical care and treatment of employees in the State Insurance Hospital or Dispensary.

as the case may be. Medical benefits have been extended to family members of the insured worker from the year 1959.

The insurance scheme is administered by an autonomous body called "the Employees' State Insurance Corporation". The Corporation has been constituted with representations from employers, employees, the medical profession, the Central and State Governments and the Parliament. The scheme is financed from a fund built by the contributions of employers and employees and by the grants of the Central and State Governments. The Central Government defrays the administrative costs, while the State Governments bear the medical costs. For contribution purposes, employees have been divided into eight wage groups, the lowest group comprises workers who earn less than Re. 1 per day and the highest group consists of those employees who earn Rs. 8 or more per day. The highest group contributes Rs. 1.25 per week, and the employees earning between Re. 1 and Rs. 1.50 contribute 12 paise per week, the lowest group being exempted from making any contribution. On an average, employers contribute 1¼% and employees contribute 2½% of the wages. With effect from 1st April, 1962, the employers' contribution in implemented areas has been raised from 1¼% to 2½%.

The Employees' State Insurance Act was amended in 1966 to provide for (*a*) raising the wage limit from Rs. 400 to Rs. 500 per month, (*b*) enlarging the definition of the term employee so as to cover staff engaged in administration, distribution, purchase, etc., (*c*) exempting employees who earn less than Rs. 1.50 per day from making any contribution and (*d*) enabling recovery of contributions on a like basis of land revenue arrears.

By the end of 1967-68, the scheme was in operation in all States giving benefits to nearly 35 lakh industrial workers at 274 centres. During the Third Plan period, the scheme was extended to all those centres which have concentration of at least five hundred workers so as to cover about 30 lakh industrial workers.

4. *The Coal Mines Provident Fund and Bonus Schemes Act*, 1948—The Act provides for the payment of bonus equivalent to four months' basic wages during a year to the coal miners and for the institution of a compulsory provident fund with equal contributions from colliery workers and owners. The object of the bonus scheme is to permit the coal miners to defray unusual expenses without taking resort to money-lenders, and the provident fund is designed for safeguarding the miners against destitution on retirement from services. The Central Government is empowered under the Act to frame the necessary provident fund and bonus schemes determining the scope as well as the mode of operation of the scheme.

The bonus scheme has been introduced in all collieries in Bihar, West Bengal, Madhya Pradesh, Orissa, Assam and Andhra Pradesh for

the benefit of those coal miners who earn not more than Rs. 300 per month as basic wages. Employees covered by the scheme are entitled to get a quarterly bonus equivalent to one-third of their basic earnings for the quarter. To become eligible for the bonus, there is a qualifying period of attendance during each quarter which varies from 54 days to 65 days in different States.

Both colliery workers and owners are required to make equal contributions towards the provident fund scheme. The rate of workers' contribution is 8 per cent (raised from $6\frac{1}{4}\%$ in January 1963) of their total emoluments including dearness allowances and the value of food concessions. The scheme is administered by a board of trustees constituted by representatives of employees, employers, the Central Government and State Governments. Day-to-day administration is entrusted in the hands of the Coal Mines Provident Fund Commissioner. For meeting administrative expenses, employers are required to bear a separate levy of 5 per cent of the amount of joint contributions made by the employees and employers. Towards the end of March 1968, about four lakhs of colliery workers in nearly 1,300 coal mines were subscribing to the Coal Mines Provident Fund which has grown up to an amount of Rs. 72 crores on February 15, 1968.

5. *The Employees' Provident Fund Act*, 1952—The encouraging results of the coal mines provident fund scheme have brought in its wake a similar scheme for other industries under the Employees' Provident Fund Act, 1952. Initially introduced in six major industries, viz., cement, cigarettes, engineering, iron and steel, paper and textiles, the Act has been extended to an ever-increasing number of industries. Towards the end of December 1967, the Act was operative in 112 industries with a total membership of 5.1 million. And the gross provident fund contribution amounted to Rs. 1,048 crores by the end of November 1967.

The rate of contributions has been raised from January 1, 1963 from $6\frac{1}{4}$ per cent to 8 per cent in the case of 54 industries. Many private firms in which satisfactory provident funds are in operation over a period have been granted exemptions. Because of this exemption, about 30 per cent of the establishments covered by the Act have not come under the scheme. In 1960 the coverage of the scheme has been extended by lowering the employment limit of establishments from 50 or more persons to 20 or more persons. But the enhanced rate of contribution is applicable to only those establishments which employ 50 or more workers.

The scheme is administered by a central board of trustees constituted by representatives of employees, employers, and the Government at Central and State levels. The Central Provident Fund Commissioner is the chief executive for running day-to-day affairs, and under his con-

trol, there are twenty regional commissioners in 20 regional offices spread throughout the country.

INDUSTRIAL HOUSING

Many of the maladies in the labour front stem from the horrible conditions of industrial housing in India. The existence of *chawls* in Bombay, *bustees* in Calcutta, *cheries* in Madras and *abatas* in Kanpur is not only a slur on the industrial progress of the country, but such living conditions have become the greatest killer of labour efficiency as well. Wholesome and congenial housing accommodation is universally recognized as the key to good health, efficiency and morale of the working class. Pointed references to workers' deplorable living conditions were made in different quarters after the report of the Royal Commission on Labour in 1931. But no tangible efforts were directed to improve matters on housing before the fifties of this century. Although a number of tenements were constructed by some benevolent employers here and there for housing a small percentage of their employees, such dwelling houses proved to be no better than improved *bustees* and *chawls*. Barring some honourable exceptions, one-room tenements with poor sanitary arrangements were the residential houses meant for industrial workers.

Acting on the suggestions and recommendations of different committees and conferences, the Central Government decided in 1948 to construct one million workers' houses within a period of 10 years and to organize a Housing Board for the purpose. To accelerate the tempo of housing activities and to provide for better type of tenements, the Planning Commission prepared an elaborate Subsidized Industrial Housing Scheme which was put into operation in September 1952. A separate Ministry of Housing has been established by the Central Government and the State Governments have set up Housing Boards for the execution of the housing scheme. Under the scheme, loans and subsidies are given to the State Governments, employers and workers' housing co-operatives for constructing workers' houses in accordance with certain minimum standards of specifications. As regards the amount of subsidy, 50 per cent of the total cost of construction including the cost of land is payable to the State Governments, while private employers and workers' housing co-operatives are entitled to subsidies up to 25 per cent of the total cost. Loans amounting up to 50 per cent and 65 per cent of the cost of construction can be secured by State Governments and housing co-operatives respectively with terms of repayment spread over a period of 25 years. Private employers are also entitled to loans, repayable in 15 years, up to 50 per cent of the total cost of construction.

During the First Plan period, there was a construction programme of 80,000 tenements costing about Rs. 22.6 crores. Towards the end of the First Plan, a sum of Rs. 23.13 crores was sanctioned to the State Governments, employers and housing co-operatives as subsidies and loans. But the number of tenements completed by that period was lagging far behind the targets, the actual performance being almost half of the planned number of 80,000 tenements. Up to the end of the Second Plan, the construction of about 140,000 tenements costing Rs. 45 crores was approved. Of the 1.4 lakh tenements, about one lakh tenements were actually completed and the rest were under different stages of construction by the end of 1960-61. In the sphere of subsidized industrial housing, the Third Plan provided for the construction of 73,000 tenements costing Rs. 29.8 crores. For the benefit of other industrial workers, there were separate provisions for dock labour housing, plantation labour housing and mining labour housing. The overall targets for all types of housing during the Third Plan were fixed for the construction of 900,000 houses as compared to about 500,000 in the Second Plan.

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 24 : PERSONNEL MANAGEMENT

1. Discuss the precise role and functions of personnel management in an industrial organization.

2. Explain the contributions of job analysis towards the selection of right men in the right place. Is job analysis widely effected in Indian industries? What are the usual sources of recruits for skilled and unskilled personnel?

3. Outline a common procedure for the selection of personnel. Do you think that recruitment practices in India have developed on sound lines? Give an idea of the actual practices followed in India.

*4. What do you mean by the concept of job evaluation and merit rating? How do they help towards better personnel management? Explain their usefulness in fixing employee remuneration as well as in matters of job placement, promotion and transfer.

*5. What are the benefits derived by industrial enterprises through education and training of workers? Discuss the different methods of training that are pursued in the industrial world.

6. State the important methods of training with regard to management and supervisory personnel. Explain the nature and purpose of the T.W.I. programme in this respect.

7. What do you mean by turnover and absenteeism of labour? What are the extent and consequence of labour turnover and absenteeism in Indian industries?

Do you think that the migratory character of Indian labour is the main cause of this malady? Suggest some remedial measures for labour turnover and absenteeism.

*8. Discuss the main causes of comparatively poor efficiency of Indian workers.

Chapter 25 : Industrial Relations

9. What do you understand by industrial relations and what are the aims of industrial relations?

10. What is implied by the division of employee needs into financial, personal and social ones? Suggest some means by which personal and social needs of employees can be satisfied for motivating them towards peak performance.

*11. Explain the important determinants of human relations and state how do they create the will-to-work in the minds of employees.

*12. What do you know about labour participation in management in India? Do you think that the formation of joint labour-management councils would pave the way for good industrial relations? Critically discuss the future of joint councils in India.

*13. Explain the importance of discipline in securing high industrial productivity and in developing better industrial relations. Give some suggestions for maintaining satisfactory discipline in any industrial organization.

14. "Discipline is what the leaders make it". In the light of this observation, list the managerial faults that add to the breach of discipline in an industrial enterprise. What are the contributions of the all-India Code of Discipline in this respect?

*15. What are the causes of industrial disputes in India? Briefly describe the machinery for settling industrial disputes in the country.

16. What are the aims and objects of trade unions? Indicate the weaknesses of trade unions in India and suggest some remedial measures for overcoming their weaknesses.

17. Trace the growth of trade unionism in India and indicate its present problems. Do you think that it is necessary to secure compulsory recognition of unions by law?

18. Briefly state the voluntary and statutory methods that are employed in India for the settlement of industrial disputes.

Chapter 26 : Wage Systems

19. What are the considerations involved in wage payment? For the payment of fair wages, what are the recommendations of the Fair Wages Committee appointed in India?

20. What are the comparative advantages of time wages and piece rates as two separate forms of wage payment?

*21. Discuss any two incentive plans of wage payment that have wide application in the industrial world.

*22. What are the possibilities and limitations in having profit sharing schemes in Indian industries?

23. What have been the principles followed in India for fixing minimum wages for industrial workers? Give an account of the recent formation of wage boards in different industries.

24. The issue of wage payment is circumscribed by a number of statutes in India for safeguarding the rights and interests of industrial workers. Briefly indicate the statutory measures in this respect.

CHAPTER 27 : EMPLOYEE WELFARE AND LABOUR LEGISLATION

25. Indicate the nature and extent of welfare activities prevalent in Indian industries at the present time. How do they help in promoting employee morale and in maintaining good industrial relations? What are the prerequisite conditions for the successful application of welfare measures?

26. State briefly the nature and scope of existing factory legislation in India.

27. What are the prevailing statutory measures for protecting the rights and interests of planters and miners in India?

*28. What are the principal measures so far enacted by the Government of India to assure social security to industrial workers? Briefly describe their main features.

*29. Point out the need for, and the conditions of housing for industrial workers in India. Indicate the extent of housing activities undertaken by the Government under the five-year plans.

PART NINE—MARKETING ACTIVITIES

CHAPTER 28

PRODUCT MARKETS AND MARKETING FUNCTIONS

MARKET AND ITS CLASSIFICATION

A market means any meeting of buyers and sellers for the exchange of title to the goods, irrespective of the manner of their meeting. Buyers and sellers may meet together in a direct or an indirect manner without making any physical transfer of goods consequent upon sales. The market provides the mechanism for the sale of goods, but the actual delivery of goods may not take place in all cases. Hence, the term market has a wider significance than the ordinary notion of it as a centre in which goods are physically exchanged between buyers and sellers.

Markets may be classified in several ways from different approaches : (*a*) From the standpoint of geographical area, markets are divided into domestic and foreign ; domestic markets include the local, regional and national markets. Foreign or international market involves the sale of goods beyond national boundaries. (*b*) According to the position of sellers in the market, there are primary, secondary and terminal markets. In the primary market, primary producers of farm products or manufactured goods sell to wholesalers who assemble the goods from different sources of production. In the secondary market, wholesalers sell the goods to retailers for further selling. Consumers purchase the goods in the terminal market from retailers. (*c*) According to the nature of transactions made within or outside the organized exchanges, there are spot market and futures market. In the spot or physical market, goods are physically transferred from the seller to the buyer either immediately or on a future date. Spot transactions are made on the organized commodity exchanges as well as in the outside market. Futures market refers to those commodity exchanges which are organized for making "futures contract" without entailing actual delivery of goods from the seller to the buyer. To be sure, futures transactions are made for speculative and hedging purposes. (*d*) According to the nature of goods handled, markets are divided into the industrial consumption market and the domestic consumption market. In the industrial consumption market, raw materials are dealt in, while finished products find their display in the domestic consumers' market.

respective - Different
nsequent - Following
otion - Idea

4. Regional - Sectional
5. Terminal - In way
6. Speculative - Theoritical
7.

MARKETING FUNCTIONS

Marketing is the process of making the goods available to the ultimate consumer from the point of their origin. To place the goods in the hands of consumers, an integrated group of activities is involved in marketing. Marketing functions cover all those activities which are required for the journey of goods from the producer to the consumer. Goods require some preparations, undergo many operations and pass several hands before they reach the final consumer. Marketing functions consist of all such efforts and activities. The following are the important functions of marketing :

1. Buying 2. Selling	Functions of exchange
3. Transportation and Traffic Services 4. Storing 5. Standardization, Grading, Branding, etc.	Functions of physical treatment
6. Market Financing 7. Pricing 8. Risk Assuming (or insurance) 9. Advertising and Sales Promotion	Ancillary Functions

Of these marketing functions, transportation and traffic services have been dealt with in Chapter 29 and advertising and sales promotion in Chapter 30 ; others have been discussed in the present Chapter.

BUYING

Buying is an important function in all business concerns. Manufacturing concerns are required to purchase huge quantities of raw materials and other requisites. Trading concerns buy goods for the purpose of selling them to others. Buying is interlinked with selling, and profit is equally dependent like sales upon effective buying of goods. Buying involves decisions as to the quantity, quality and variety required to be purchased ; it also calls for determining the time of purchase, source of supply and the terms of purchasing. The buying function is nowadays entrusted to a centralized purchasing department which maintains regular contacts with different sources of supply. All purchases are made according to specifications set up for the goods.

Goods are purchased in four different ways, viz., by *inspection, sample, description* or *grade.* In the case of purchase by inspection, goods are actually examined on the spot at the time of buying. All local purchases and retail transactions are usually made on this basis. This becomes the only equitable method of purchasing where goods are not

of uniform quality or character. A purchase by sample obviates the necessity of examining the entire lot of goods on the part of buyers. A distant buyer is informed as to the quality of goods by a token sample of goods which is supposed to represent the actual goods. As all goods are not capable of accurate sampling, this method of purchase is not suitable in some cases. Where purchase by sample is not practicable, purchase on the basis of description may be resorted to by the buyer. The seller gives a detailed description of the goods through issuing catalogues or making correspondence. The greater the reputation of the seller, the better the chance of accepting the description on the part of buyers. From the standpoint of sellers, it is more economical than the sale by samples. Foreign transactions are usually made on this basis, particularly in the case of machinery and equipments. Where the goods are standardized and divided into certain recognized grades, purchasing on the basis of grade is the usual mode of transactions. This method of making transactions is advantageous to both the parties and is the only basis of futures trading on organized produce exchanges.

Assembling is a distinct and separate function from buying in the marketing process. Buying results in the transfer of ownership of the goods, but it does not amount to the concentration or collection of goods under the control of the buyer. Assembling is the consequential activity of all buying efforts. It brings together at certain central points all those goods which are purchased from scattered areas of production so as to make them available for consumption or shipment. It amounts to the creation of stocks desired for one purpose or other.

SELLING

The primary objective of business enterprises is realized through sales by way of supplying desirable goods and services to consumers. Furthermore, since profit is the surplus of selling price over the cost of doing business, sales provide the elixir of life for the continued existence of business, and all other activities of the business are supported by the sales volume. The present-day mass production has been sustained by the development of mass-selling techniques. As the volume of production can be increased to almost any extent by expansion, it is sales that demand utmost attention, care and thought of businessmen. With every increase in the frontier of sales, the enterprise progresses a step further.

Because of the predominating importance of sales in marketing, sales promotional efforts are continuously dovetailed with the regular selling activities. Sales promotional work consists of market study, product planning, demand creation and dispersing. The market is thoroughly studied to find out the requirements of consumers, and on the basis of such study the product is planned in respect of design,

performance and cost to meet the consumers' demand. Demand creation is made with the object of stimulating the desire for goods and of inducing the prospective purchaser to buy products of a particular make. Besides the two basic methods of demand creation, viz., personal solicitation and advertising, various other methods like exhibitions, display, demonstrations, informative literature and samples are employed to supplement the appeal for goods. *Dispersing* is the reverse of assembling, and it is concerned with devising means by which buyers can be assured of getting goods easily and promptly at all places every now and then. It involves the distribution or spreading of goods throughout the market area.

As in the case of buying, sales are made on the basis of inspection, sample, description or grade. The actual sales work is usually composed of enquiries, quotations and orders on the part of a manufacturing concern dealing in consumers' goods. All these matters are usually handled by a separate Sales Department, the organization of which varies between concerns according to the number of products dealt in, the size and character of the market involved, and the methods of distribution adopted. In the case of industrial consumption goods, after-sales service becomes necessary in most cases. Apart from these selling problems of manufacturing enterprises, the marketing enterprises engaged in wholesaling and retailing have to face the task of selling on a different footing. (The differing nature of wholesale and retail selling has been explained in Chapter 31).

STORING (WAREHOUSING)

Storing is an important function of marketing and adds both time utility and place utility to the goods. By preserving goods from the time of production to the time of consumption, storage aids in the steady flow of goods to the market. Further, by holding goods in different warehouses situated at several places, it ensures a prompt supply of goods to those market areas where they are wanted. If transporting and advertising are designed to widen the market, then storage must be taken for deepening the market. As production is made nowadays in anticipation of demand, storage becomes indispensable at some point or other in the marketing process. The necessity of storage may be summed up in the following ways :

1. Some commodities are produced seasonally, but their consumption is evenly spread throughout the year. Most of the farm products fall under this category; and for ensuring their steady supply, such products are to be stored after production.
2. Storage is required in the reverse situation also when goods are produced all the year round for their use during certain season only, e.g., winter garments.

3. Modern mass production is carried on in expectation of the future demand, and thus the finished goods must be held in stock until they are demanded.
4. With the advent of cold storage and refrigeration services, perishable goods can be preserved now for a longer period.
5. Some goods require conditioning, curing or other like treatments. Storage provides the facility for undertaking these operations.
6. Goods are sometimes required to be held back for overcoming unfavourable prices or for speculative purposes.
7. Continuous production on the part of large producers is impossible unless requisite raw materials are held in store to ensure their ready availability.

Warehouses. Storage facilities are provided by both public and private warehouses. Private warehouses are owned and operated by individual business enterprises to meet their own storage requirements. In contrast to the private warehouse, public warehouses are organized for rendering storage facilities to the general public in return for a storage fee or charge. They are licensed by the State and are subject to Government regulations in respect of their methods of operation and rates of charges. Because of their vital importance in the marketing of agricultural products, a large number of public warehouses are being set up by the Government in the co-operative sector. In addition to these warehouses, there are bonded warehouses in regard to the foreign trade of the country. (Bonded warehouses have been discussed in Chapter 32).

Advantages of public warehouses—There are many advantages of public warehouses, some of which may be stated as follows :

1. As these warehouses are established at the junction point of railways and highways, they offer excellent transport facilities for the movement of goods by both rail and truck lines. Moreover, they are equipped with mechanical appliances for the handling of heavy and bulky goods, and they are provided with special railway sidings. Consequently, loading and unloading operations can be done quickly and cheaply.
2. Goods are well preserved against damage and well protected against fire or theft. Buildings of public warehouses are specially designed to guard against several risks. Public warehouses are constantly watched and inspected by warehouse owners because of their liability as bailees for the goods. Further, goods are invariably insured because of lower premium rates resulting from all such safety measures.
3. They appear as a boon to small manufacturers who cannot construct their own warehouses. Even large manufacturers are compelled to make an extensive use of these warehouses for carrying regional stocks in different centres without having their own warehouses and warehouse keepers thereof.

4. Manufacturers or merchants are required to pay rent for the actual time and space utilized in the public warehouse. This makes for an economy in storage charges.
5. Receipts issued by public warehouses form an excellent collateral for raising bank loans. Because of this facility, goods can be held in the warehouse to tide over unfavourable market conditions.
6. Goods can be inspected by prospective buyers when they are kept in the warehouse. The goods may also be graded, processed, conditioned or packaged by the owner to facilitate marketing.
7. Public warehouses render a variety of services. They receive goods in different lots and arrange for the delivery of goods in the desired way as instructed. They prepare invoices for goods delivered on behalf of the seller. They secure economies in transport charges for the movement of odd-lot goods by pooling different deliveries together so as to make one complete wagon-load or truckload of goods.

STANDARDIZATION, GRADING AND BRANDING

A standard is an established criterion or concept of quality which provides a model for comparison between products of the same kind. Standards describe the nature and characteristics of products with reference to their size, shape, colour, performance and like requisites. A standard conveys the idea of uniformity and identity in respect of quality or some other matters. In manufacturing operations, the standards play an important part in securing efficiency and economy. Not only finished products are standardized, but materials, processes and performances also are standardized. As manufactured goods are standardized in the productive process, they do not require any standardization in the sphere of marketing. But farm products and mining products are supplied in the market in different qualities and with varying features. There is a lack of uniformity or standardization in the variety of natural products available from the soil. Standardization becomes an important marketing function in such cases in order to facilitate sale and purchase of goods.

In contrast to manufactured goods, the natural products can never be standardized perfectly, and there must be some variations between two or more products. Nevertheless, such products are capable of being divided, assorted or classified into certain common lots. This is what is done through grading. Grading involves the division of products with reference to some predetermined standards or measures of quality. As manufactured goods are turned out by machines with a high degree of

accuracy, the question of grading becomes completely irrelevant in such situations. To aid marketing, finished goods are, however, required to be branded. But branding is an entirely different work from grading. (And to treat these two activities under the same footing adds to their confusion rather than to a clarification. For avoiding misunderstanding, grading should be separated from branding in the discussion of marketing functions).

Grading. Grading is the method of dividing products into certain common groups or lots in accordance with predetermined standards or norms. Grading may be of two types : fixed grading and variable grading. In the case of fixed grading, different grades are kept at some fixed level from year to year, and products are classified according to the fixed value of the grade. Wheat, cotton and butter furnish common examples of this type of grading. But in the case of variable grading, the grade value is required to be changed depending upon the quality of production from year to year. According to the quality of the available supply, the products are divided into different classes, as in the case of fruits, vegetables and eggs.

Advantages of grading—There are several advantages of grading. *First,* grading widens the market and makes the marketing of goods an easy task. Distant buyers can purchase the goods on the basis of established grade without inspecting the quality of products. Buyers and sellers are required to confine their bargains only to the price of products, and bargains over other requisites of sales become unnecessary. *Secondly,* the cost of marketing comes down in the case of standardized and graded products. As a result, goods become cheaper to the consumers who are encouraged to make increased purchases. Market informing through the efforts of salesmen or of advertising for each individual lot of goods becomes unnecessary. *Thirdly,* the buyer is assured of quality products at a fair price. As the market news of supply and price gets publication, artificial price difference or quality difference between products of two sellers in the market cannot be maintained. This ensures justice to the consumer. *Fourthly,* it reduces the cost of financing, as graded products form a better collateral for loans as compared with ungraded goods. Where grading exists, a greater amount can be borrowed at lower rates against the security of goods. *Fifthly,* the cost of transportation and storage is also reduced. The desired products are stored and shipped to the market as demanded by consumers, and unnecessary returns of goods are avoided. Storage and transport costs on unmarketable goods need not be incurred by the seller. *Sixthly,* as graded products can be easily valued, the collection of claims from insurance companies, railways or warehouse-men is facilitated when goods are lost or damaged. *Finally,* grading may give rise to the benefits

of futures trading, since futures transactions are only possible in the case of graded products.

Limitations of grading are confined to the methods and practices adopted for the purpose of grading. There are many products which are not capable of being divided into certain well-recognized classes. Very often, a particular grade does not describe the product accurately and minor differences are found to exist between products of the same grade. This shortcoming specially arises from the dearth of competent and honest inspectors who examine grade characteristics. The wholesalers and retailers object to grading, because they think of it as a device for exploiting them by producers and for reducing their profit margins.

Branding (TRADE-MARK). Branding has become an inseparable part of modern mass-selling process. Standardized machine products are marketed under a particular brand name with a view to identifying their sources of production and establishing the individuality of products. As already pointed out, manufactured goods do not require any grading, but they involve branding. Farm products and mining products are subject to grading ; and as a step further, they may be branded in some cases. The primary object of branding is to introduce product differentiation in the market and to single out a product from its rivals. The manufacturer protects the brand name or trade-mark by registration and maintains it by guaranteeing the quality of products. Three different methods are adopted for branding purposes : (*a*) the product is named after the name of manufacturers, such as Dalda, Godrej, Himani, etc. ; (*b*) the product may be given a special name, as in the case of Sunlight, Lux, Cow & Gate, Ovaltine, Swift-plate, etc. ; and (*c*) the product may be described by a special symbol or mark, e.g., Scissors-brand cigarettes, Bag-brand matches, Elephant-brand paper, etc.

Advantages of branding—There are many advantages of branding, of which the more important ones may be stated as follows :

1. It is a tool in the hands of manufacturers to push products in the market over their competitors. It results in the creation of some sort of monopoly in the market by winning over customers' preferences.

2. Demand creation through advertising becomes less expensive. It is true that an extensive advertising campaign is necessary to introduce a new brand. But once a brand can be established in the market, it goes on selling products with regular advertising.

3. Branding makes advertisement of its own and spreads the market deeper and wider as the time passes. Because of the customers' satisfaction, branding ensures repeat sales to old customers and new sales to prospective buyers.

4. Branding reduces the price of goods, since the manufacturer

can maintain the resale price of branded goods, and he is not required to pay much commission to dealers.

5. Retailers are forced to keep a stock of well-known branded goods because they have a pressing demand on the part of customers. Consequently, branded goods are available everywhere, and buyers can make their purchases with reasonable certainty as to quality and price of products.

6. Branded goods are invariably sold in the form of sealed packages, since the brand name is to be given on the package. Packaging protects the goods from heat, moisture, dust or adulteration, and thus preserves the quality of products.

Packing and Packaging. For transport and storing purposes, goods are to be properly packed for protecting them against breakage, spoilage, leakage or pilferage. To secure better results of packing, some significant developments like improved containers, protective chemical coatings and the use of pallets have been effected in recent years.

In contrast to packing, packaging is concerned with putting the goods in such boxes, bottles and cans as can be sold to consumers. For enhancing the value of goods on the part of consumers, domestic consumption products are mostly supplied in packaged form nowadays. A good package protects the quality of goods, assures their correct weight, and provides a means of using brand name and of giving informative literature. The packages are designed for facilitating attractive window-dressing and easy stacking in stores. To increase the attractiveness of goods, transparent packages are made in such containers as can be re-used by the consumer for other purposes after the products have been consumed.

FINANCING

Financing is an important function of both marketing and production. Like a manufacturing concern, a marketing enterprise requires fixed capital as well as working capital. However, the requirement of fixed capital is comparatively much lower than that of working capital. Working capital is needed in marketing to carry stocks of goods, to extend trade credit, and to meet operating expenses like salesmen's wages, advertising, transporting and office expenses. The same considerations as are required in the case of physical production go to determine the amount of working capital, namely, (*i*) the volume of business transacted, (*ii*) the rapidity of stock turnover, (*iii*) the nature of the business and value of goods, (*iv*) the terms of purchase and sale, and (*v*) liquidity facility of current assets.

There are three important sources of capital to a marketing enterprise—owner's investment, bank credit and trade credit. It is needless to point out that the greater the amount of owner's investment, the better will be the standing of an enterprise in the market. The entire amount of fixed capital and at least 50 per cent of the working capital should be covered by the owner's investment; and this amount is regarded as the irreducible minimum. Short-term borrowing from commercial banks and other agencies are made by almost all concerns. These borrowings are necessary during periods of seasonal peaks when an extra amount must be found out. But when borrowings are made during the normal period, they do not indicate a healthy sign because of their permanent employment in the business. The manufacturer extends trade credit to wholesalers who, in turn, allow such facility to retailers. Trade credit enables the manufacturer and wholesalers to increase sales, to enhance reputation and to strengthen their positions in the market.

In our country, internal trade is financed by various indigenous bankers, commercial banks and foreign exchange banks, while foreign trade is supported mostly by the exchange banks and large commercial banks. The banks give advances by way of loans, overdrafts and cash credits as well as by discounting hundis and bills. In the marketing of farm products, indigenous bankers supply funds in the primary market, commercial banks in the secondary market, and the foreign exchange banks in the terminal market for foreign shipment.

PRICING

Price is the governor of marketing activity, since sales are mainly circumscribed by the pricing of products. Price is determined by the top executives in such a way that it may bring the largest volume of sales with a sufficient profit margin. A number of considerations are involved in the pricing of products. *First,* the price must be high enough to cover all costs of production, but at the same time, low enough to attract customers. *Secondly,* the extent of competition that a particular line of product has to face in the market often influences the pricing of products. For the sake of competition, varying margins of profits may be required to be fixed for the different products of an enterprise. *Thirdly,* the marketing process calls for determination of several prices for different parties, viz., wholesale price, retail price and consumer price. These price differentials must be satisfactory to all parties. Otherwise, traders may not push the goods in the market, and consumers may be driven to products of other concerns.

Resale Price Maintenance. In the case of domestic consumers' goods, resale price maintenance has become the accustomed practice of all manufactures. The manufacturer sets the price at which the

wholesaler is to sell the product to retailers, and also the price at which the retailer should sell the goods to consumers. This determination of wholesale, retail and consumer prices is known as resale price maintenance. The principal advantage lies in the price stability that it brings to the benefit of all parties. The consumer is required to pay a fixed price wherever he may purchase goods. The dealers are assured of a steady margin of return in the handling of these products. The manufacturer can count upon a steady rate of return in respect of his future production. This resale price maintenance protects the weak and inefficient retailers from being undersold by other retailers. But the consumer is deprived of the benefit of a possible price reduction.

The proponents of resale price maintenance argue that the system of price-cutting casts a demoralizing influence on the market. Price-cutting undermines public confidence, and consumers become sceptical about the fairness of prevailing prices. The profit margin of both dealers and manufacturers may be affected to such an extent that products are ultimately displaced from the market. But resale price maintenance can be defended so long as this practice remains confined to individual manufacturers. By means of concerted action on the part of several manufacturers, resale price maintenance has been found to be a tool for charging monopoly prices, exploiting consumers and keeping off potential competition.

Price Marking. At the retail level, prices of goods are usually marked on them. For allowing the desired margin of profits, prices are marked up in relation to the cost of merchandise. The mark-up is effected on the basis of either selling price or cost price by adding certain percentage thereto. In some cases, prices are marked at odd figures, such as 37 paise instead of 40 paise, and Rs. 9.95 instead of Rs. 10.00. The logic for using such odd prices is that they appear more attractive and stimulate sales. For the same reason, prices are marked sometimes at figures like Rs. 10.95 rather than Rs. 11.10 and Rs. 11.95 rather than Rs. 12.05. It is claimed that the former prices give an impression of something deducted from the price of products and the latter creates a feeling of something added to the price. Opinion is divided as to the usefulness of these odd prices or markdown prices. No doubt, all such novel price markings are bound to appear as customary prices after the lapse of a period. The experience of other countries shows that such price markings make little difference in sales. Many large-sized retail stores in the U.S.A. and the U.K. are positively against the use of such odd prices. But the Bata Shoe Company in our country has placed too much importance on the use of odd price marking. According to the prevailing world trend, it is doubtful whether odd price marking creates a better consumer response.

The use of *price line* has become important nowadays in the field of retailing. A series of predetermined prices is adopted in the marking of products dealt in, whether trading is confined to a few products or to a number of products. Price line assists the retailers in buying, pricing, record keeping as well as in pushing sales among consumers of different income groups. Consumers can select the goods easily, compare their values, and make necessary bargains as they please. However, to offer the goods at certain fixed prices within the price line, the retailer is required to select the product items in such a way that their prices can fit in with the pattern of the price line. Normal selling prices are to be marked up or marked down in some cases in order to accommodate them in the accepted price line. Leaving aside profit margins on individual items, overall trading margin is stressed under this system of price marking.

RISK ASSUMING (INSURING)

In marketing, there are innumerable risks which are to be assumed either by the seller or by somebody else. Goods may be destroyed by fire, shipwreck, train or motor accident, flood, storm and a variety of other causes. They may be stolen, burgled or decayed. There are also the risks of falling prices, bad debts or changing demands. All these risks make the cost of marketing too high. With a view to reducing the risks, businessmen try to shift some risks on the shoulders of others and to eliminate other risks through the adoption of safety measures. In spite of these efforts, there are many other risks which must be borne by the seller of goods.

Shifting of risks—Fire, marine, accident, burglary, defalcation, bad debts and some other risks can be shifted to insurance companies against the payment of premiums. Because of this cost of shifting risks, it may not be practicable on the part of businessmen to effect several insurance. Accordingly, one or two risks are covered by insurance policies, and others are left uncovered. To guard against the price changes, no insurance cover has yet been devised. But the risk of price changes can be insured to some extent by the process of hedging transactions on organized commodity exchanges.

Elimination of risks—Risks of fire, theft and physical injury can be lessened or eliminated by the construction of fireproof building and introduction of automatic sprinkler services, by the setting up of vaults and employment of constant watchmen and by careful handling of products and equipments through trained personnel. Risk of price or demand changes can be guarded against by trend analysis, study and forecasting.

Bearing of risks—There are yet many risks which are left for the

businessmen. These are the irreducible risks present in marketing, and the burden of such risks, in their ultimate analysis, is transferred to the consumer in the shape of increased prices of products.

NATURE OF INSURANCE

Business is beset with many risks. If businessmen were required to bear all the risks upon their shoulders, business operations would have been uncertain, hesitating and halting in character. Moreover, the burden of risks would have made the goods or services much costlier than what we pay for them. Fortunately for the businessman and the consumer, the majority of business risks can be shifted to the insurance company against payment of a money consideration known as premium. The insurance company pools the risks of one particular type from a large number of persons and creates a common fund out of premium payments in order to reimburse or compensate the persons who might suffer from the risk. Insurance is a co-operative endeavour of spreading risks among innumerable persons. Through the spreading of risks over many persons, the insurance company can compensate the loss suffered by some of them, because the overall incidence of risks is comparatively small and can be subjected to almost accurate estimation.

Insurable Risks. As insurance is the business of dealing in risks, it must not be assumed that every business risk can be guarded against by an insurance cover. Whether a particular risk can be insured against or not is determined by the following five criteria : (*a*) the risk must arise out of the ordinary course of business and it should not be one which is artificially created by the parties ; (*b*) the risks must be common enough to justify its spreading at a normal cost ; (*c*) the aggregate incidence of risks must be capable of fair estimation ; (*d*) there must be an element of uncertainty as to the occurrence of risk or the time of its occurrence ; and (*e*) the party must have some real interests in avoiding the risk which should not be of a trifling nature.

Principles of Insurance. Before studying the principles of insurance, one should have some idea about the various forms of insurance that are available from the insurance company. Insurance covers may be divided into five groups : (1) life insurance (2) fire insurance, (3) marine insurance, (4) casualty and liability insurance, and (5) fidelity and guarantee insurance. Whatever might be the nature of insurance, there are some fundamental principles which must remain present in all insurance contracts. The principles are as follows :

Good faith—Insurance contracts belong to the class of contracts known as "uberrimae fidei", i.e., contracts which require utmost good

faith on the part of parties to the contract. If the parties fail to make a full disclosure of all material facts relating to insurance, the contract is not enforceable in a court of law. The onus of making a full and fair disclosure usually rests upon the party insured who is supposed to have an intimate knowledge about the subject matter. The insurance companies, or the insurers as they are called, can set aside the contract in the absence of this disclosure.

Insurable interest—The insured must have an insurable interest in the subject matter of insurance. Barring life insurance, insurable interest is evidenced in other types of insurance by the financial interest of the insured resulting from his complete or limited ownership in the subject matter of insurance. In the case of life insurance, the insured has an insurable interest upon his own life as well as upon the lives of other persons, by whose death he may be prejudiced financially. In the absence of insurable interests, the insurance contracts are rendered void. The insurable interest is required to exist in life insurance at the time of making contracts ; in fire insurance, at the time of both making contract and incurring loss ; and in other cases, at the time of loss only.

Indemnity—Except in the case of life insurance covering the risk of death, all other insurances are based on the principle of indemnity by which the insurer undertakes to compensate the actual loss suffered by the insured. Because of this indemnity principle, the insured can never get a sum beyond the value of his actual loss, although he has insured for a larger amount or has made an over-insurance by false declaration about the value of his property. The question of compensation does not arise in the life insurance contracts, since the value of a life cannot be measured in pecuniary terms. Life insurance contracts are contracts of guarantee, under which the insurer agrees to pay a stipulated sum upon the termination of the life of the insured.

Subrogation—Subrogation is an accessory principle to the contract of indemnity. To guard against the danger of excess payment arising from double insurance or over-insurance made by the insured, insurance companies have the inherent privilege of subrogation. Subrogation principle permits the insurance company to acquire the rights and interests of the party insured who has realized a greater sum than the value of his actual loss through over-insurance or double insurance. Insurers are entitled to subrogation right for the purpose of recovering from the insured any sum that may be obtained by him in excess of his legitimate indemnity claim.

Double insurance—The practice of taking insurance covers on the same subject matter from more than one insurer is known as double insurance. In the case of life insurance, the insured is at liberty to take as many policies from several companies as he likes and for any amount. But in indemnity contracts, the party should not insure the property

beyond its actual value, whether he takes policies from one or more companies. Where double insurance results in over-insurance, (i.e., an insurance protection beyond the actual value of the property) insurers from amongst themselves are entitled to rateable contributions for the reimbursement of actual loss.

However, if the property is *under-insured,* i.e., where the amount insured is less than the actual value of the property, the insured is regarded to be his own insurer for the uncovered balance and is entitled to obtain that proportion of his actual loss which the amount insured bears to this total value of property. In order to relieve the burden of insurance cover involving large amounts, it is the usual practice of insurance companies to transfer a part of their risks to other companies through *re-insurance.* Re-insurance does not affect the party insured, since it is a contract between two insurance companies.

Life Insurance. Life insurance is used in business for two different purposes, viz., protection against the loss caused by the untimely death of key personnel, and insurance protection extended to all employees in order to develop loyalty. Life insurance on the part of business enterprises has several advantages. It serves as a collateral security for raising loans, provides funds for the liquidation of debts or the repayment of capital, and secures the requisite amount of inheritance tax.

Life insurance policies are issued with varying terms like *endowment insurance, whole life insurance* and *limited payment life insurance.* In the endowment insurance, the insurance company undertakes to pay a stipulated sum on the death of the insured before a fixed period or to pay at the end of the period when the party survives. Whole life policy matures for payment only on the death of the insured, and premiums are payable throughout the life. In order to reduce the burden of these premium payments which are payable throughout the life, whole life policy may be taken with premium payments for a limited number of years. *Group insurance* and *industrial pensions* are the two important insurance covers available for the protection of lives of all employees in a business concern. One policy is issued to the employer with individual certificates indicating the amount of insurance protection for each employee. Dependants of the employee are entitled to the benefits of these insurances. These insurances partake of the combined features of both group life and whole life insurance policies.

In order to emphasise the difference between life insurance and other types of insurance, life insurance is sometimes referred to as "life assurance". But the term "life insurance" has acquired a common usage throughout the world. Life insurance differs from other insurances in several respects : (*i*) the risk of death is certain, although the time of it is uncertain ; (*ii*) it is not a contract of indemnity, but a contract of

guarantee whereby the insurer agrees to pay a fixed sum ; (*iii*) unlike other forms, life insurance is taken for very long periods ; (*iv*) life insurance requires reimbursements sooner or later, but the case of reimbursement may not at all arise in other forms ; (*v*) life insurance requires an insurable interest at the time of contracts only, and (*vi*) the question of over-insurance is immaterial in life insurance contracts, and the gradation of risks is much simpler than other forms of insurance.

Some of the important clauses in a policy of life insurance include the following : (*a*) the number and type of the policy, (*b*) name, address and occupation of the assured, (*c*) the sum assured, (*d*) the age of the assured along with its proof, (*e*) the amount of premium payable and the mode of its payment, (*f*) the name of the nominee, (*g*) surrender value of the policy and (*h*) non-forfeiture clause.

Life policies can be assigned by the policy-holder or by his authorised agent through making an endorsement upon the policy or through using a separate written instrument. The assignment can be made with or without consideration as well as a conditional or an unconditional one. Irrespective of the nature of assignment, all assignments are required to be evidenced by the attesting signature of one witness. To make the assignment complete and effective, proper notices must be given to the insurer who has to issue a receipt acknowledging the fact of such assignment. Upon a valid assignment, all rights in the policy vest in the assignee who can sue on the policy in his own name. An assignment differs from a nomination in three respects. *First*, an assignment amounts to the immediate transfer of all rights in the policy to the assignee while nomination implies selection of an heir apparent to the policy benefits. *Secondly*, an assignment can be effected by endorsement on the policy or by a written instrument, but a nomination can be done through endorsement on the policy alone. *Finally*, an assignee takes all the interests in the policy and can sue in his own name ; no such rights vest in the nominee.

Fire Insurance. The standard fire insurance policy that is available from insurance companies is designed to provide against fire risks. The standard policy contains the name of the parties, the description of the property, the sum insured, the amount of premium, the period of insurance and the peril insured against. The policy provides protection against loss or damage by three perils, viz., fire, lightning and explosion. Losses occurring as a result of war, riot, civil commotion and others are usually excluded from the scope of this policy. Unlike other policies, a fire policy cannot be assigned by the insured, as it is a personal contract between the parties. By the insertion of an average clause, the insurer protects himself against under-insurance of the property.

In order to meet the varying demands of the insured, the standard

policy is issued with various modifications and adaptations. Some of the important variations are specific policy, floating policy, blanket policy, comprehensive policy, sprinkler leakage policy and consequential loss policy. (1) The *specific policy* provides for the payment of a specific sum in respect of loss to the property and does not penalise under-insurance. (2) The *floating policy* covers several lots of goods lying in different places under one insurance cover. (3) A *blanket policy* is issued to cover all the fixed and current assets of an enterprise by one insurance. (4) *Comprehensive policies* are issued to extend the coverage of risks due to civil commotion, riot, theft, labour disturbances and the like. (5) *Sprinkler leakage policies* cover the loss arising out of water leakage from sprinklers which are set up to extinguish fire. (6) The resulting loss of profit following the outbreak of fire is covered by the *consequential loss policy.*

Besides the average clause, the following are some of the special clauses found in a policy of the fire insurance :

i. *Waiver clause*—The insurer's liability ceases if the party insured changes his line of business or shifts the property insured to other places without the consent of the insurer.
ii. *Salvage clause*—Under this clause, the insurer becomes entitled to enter the premises for reducing the amount of loss as soon as he receives a notice thereof.
iii. *Excepted perils clause*—Some perils like riots, civil commotions, floods, earthquakes, etc. are excluded from the coverage of the policy.
iv. *Reinstatement clause*—The insurer acquires the option of reinstating or replacing the property lost rather than paying a claim for the loss.
v. *Lost or not lost clause*—In the absence of fraud, a valid policy can be taken in regard to that property which is even lost or destroyed at the time of effecting insurance.
vi. *Retrospective clause*—A policy taken on a subsequent date may cover risks prior to the date of effecting insurance, provided the insured was ignorant about the loss.
vii. *Arbitration clause*—It provides for settling all disputes through arbitration.

Marine Insurance. Marine insurance offers composite policies covering hull insurance to the owner of the ship, cargo insurance to the owner of goods and freight insurance to the shipping company. The subject matter of marine insurance is thus cargo, freight or the hull. The marine policy is issued to indemnify the assured against losses occurring from the maritime adventure. Marine policies cover many risks of the sea voyage, as opposed to one risk in the case of fire

insurance. The usual risks covered by a marine insurance policy are sinking, stranding or burning of the ship and its contents as well as collision, jettison, barratry, piracy and explosion. War risks of arrests and restraints may also be included on the list. *Jettison* is the wilful throwing of goods overboard the ship with the object of rescuing the vessel from some imminent danger. *Barratry* is the wrongful act done by the captain of a ship in destroying or stealing the vessel or cargo to the detriment of owners thereof.

The marine policy is mostly issued in the Lloyds standard form which contains all the terms and clauses of the contract. The policy includes the name of parties, the subject matter and risks insured, the class of policy and the sum insured. There are some warranties, both express and implied, which must be strictly complied with by the parties. Express warranties are neutrality of the ship and its readiness to undertake the voyage on a particular day, whereas seaworthiness and legality of venture are the two implied warranties in all marine insurances.

Several types of marine policy are issued to suit the requirements of varying circumstances. (*i*) *Time policies* are taken by the shipowner to cover all marine risks for a specified period, usually on the yearly basis. Cargo owners may also take up time policies covering all shipments during a fixed period. (*ii*) As opposed to time, each voyage is made the basis of marine insurance for covering the related risks from the port of departure to the port of destination. Generally the cargo owner takes the *voyage policy* for each separate shipment of goods. (*iii*) *Mixed policies* are issued by combining both the time and voyage features under one coverage. (*iv*) *The floating policy* is popular with merchants who make regular and frequent shipments of goods through an established route. Instead of taking many individual policies, one running policy is taken and the necessary particulars relating to the voyage are given by subsequent declaration at the time of each separate shipment. (*v*) *A blanket policy* is a variant of voyage policies covering losses within fixed areas and time limits. The entire premium is paid on an estimated value of goods, and subsequent premium adjustments are made between the parties in the light of the actual value of goods. (*vi*) Marine policies are mostly *valued policies* nowadays, and unvalued policies are rarely issued. The valued policy contains the insured value of goods which is made up of invoice price, charges like freight, shipping and insurance, and 10 per cent margin to cover profits and other incidental expenses. That is, it is the C.I.F. price plus 10 per cent profit. (*vii*) *Fleet policies* are taken by the steamship company to insure all the vessels under one policy instead of arranging separate policies for each vessel. All vessels, old and new, are subjected to a uniform premium rate.

There are two types of marine loss, viz., Total Loss and Partial

Loss. A ship and its contents may be totally lost by actual sinking or in a constructive way through stranding on a rock. That is, a total loss may arise in actual or constructive manner. Partial Loss includes all part losses and damages to either goods or vessel. As regards the basis of risk-bearing, the partial loss is divided into two categories—*General Average* and *Particular Average.* The general average loss is to be borne by all the affected parties *pro rata,* since this loss is incurred to save the ship, as in the case of jettison. The particular average loss is assumed by the affected party only and is not shared by others. Insurance protection can be taken covering total loss or partial loss, or both. When a policy covers both total loss and partial loss, a claim for the total loss can be made in the case of total destruction. If it cannot be substantiated, a claim for the partial loss can, however, be made from the insurance company.

Unless prohibited by the agreed terms of the policy, the insured can always assign his rights and interests in the policy to any person either by an endorsement on the policy or by a separate written instrument of assignment. The assignment of policy interests can be made at any time, whether before or after the loss has taken place. For valid assignments, the assignee must have "insurable interest" at the time of making such transfer, and proper notice must be given to the insurer informing details of assignment. After assignment the assignee acquires the rights of the insured and can sue on the policy in his own name.

Some important clauses in a policy of marine insurance are as follows :

1. *Lost or not lost clause*—By this clause, the insurer undertakes to cover risks pertainting to a vessel, irrespective of the fact as to whether the vessel is actually lost or not on the date of effecting insurance. However, the insured must not practise any fraud, and at least he must remain unaware of any loss, if any.
2. *S. L. T. clause*—This clause imposes an obligation upon the insured to "sue, labour and travel" and take other steps for the preservation of insured property in case of necessity. The insurer's liability is reduced by the value of property saved from loss. And in exchange for the benefit, the insurer charges a lower rate of premium with S. L. T. clause.
3. *Running down clause*—When the vessel of an insured collides with another vessel and he is required to pay compensation to the owner of the damaged vessel, the running down clause in the marine policy comes to the rescue of the party insured. Such compensation is paid by the insurance company.
4. *Touch and stay clause*—Under this clause, the vessel is permitted to touch and stay in regular and scheduled ports over the normal route of navigation. Deviation from the usual course

of its journey is only permitted in emergencies for the safety of the ship and the lives of its passengers.

5. *F. P. A. and F. A. A. clause*—The F. P. A. clause (free of particular average) relieves the insurer of the liability in respect of particular average. The F. A. A. clause (free of all average) exempts the insurer from liability accruing from both general average and particular average.
6. *F. C. and S. clause*—The "free of capture and seizure" clause excludes the perils of vessel's capture and seizure by enemy countries during periods of war. To cover such unusual risks, a separate arrangement is required to be made through the payment of an extra "war risks" premium.
7. *Continuation clause*—This clause prolongs the period of the time policy taken by a vessel to complete her voyage to the port of destination. For extending the period of policy, previous notice is to be given to the insurer and a *pro rata* monthly premium is to be deposited.

Casualty and Liability Insurance. The risk of damage to the body or property of a person and the consequent liability therefrom can be covered by an insurance. Of this group, motor insurance, third party insurance and personal accident insurance are comparatively important.

Motor insurance—The owner of a motor vehicle is exposed to two types of risks, viz., (*a*) damage to the car by accidents and fire or the loss of the car by theft, and (*b*) liability arising out of death or bodily injury to any person in a public thoroughfare. The second risk of personal injury to any third person is now required to be compulsorily insured under the Motor Vehicles Act, and injury to the salaried driver under the Workmen's Compensation Act. But as regards damage to or loss of the vehicle, the owner may or may not take any insurance. A comprehensive policy covering all risks can, of course, be had from an insurance company.

Third party insurance—The liability arising out of damage made to the person or property of any third party is covered by third party insurance. Compulsory motor insurance covers a part of the insurance protection given by the third party policy. Such insurance policy assumes risks of personal injury to third parties, and not the risk of any damage to their property. Third party insurance covers both the risks of property damage and personal injury to any outsider. Consequently, it is also known as liability insurance. This liability insurance can be made in several other cases, namely, employer's liability to employees for accidents, house-owners' liability to neighbours, and the like. Third party insurance differs from motor insurance in respect of its coverage of risks. The comprehensive motor insurance is a combined policy covering

both property and accident risks, whereas third party insurance is only a liability insurance.

Personal accident insurance—It is a contract under which the insurer agrees to pay to the insured or his representative a stated sum of money in the event of his death or physical incapacity by accidents. This insurance is made to cover three risks : personal accidents only; accidents and specified diseases, and accidents and all sicknesses.

Fidelity and Guarantee Insurance. *Fidelity insurance*—Fidelity insurance is made by the employer to provide against the risks of financial loss arising out of defalcation on the part of employees in their handling of funds or goods of the enterprise. The insured is to give all material facts and information to the insurer relating to his employees, and the terms of employment cannot be changed without the knowledge of the insurer. The insurance company undertakes to indemnify the employer against financial loss occurring through the employees' fraud and dishonesty.

Commercial insurance—*Credit insurance* and *title insurance* are two important forms of commercial insurance. In the case of credit insurance, the insurer undertakes to indemnify the insured against the loss arising out of insolvency of his debtor. Credit-worthiness of his debtors is guaranteed by the insurance company to the party insured. In order to remove the possibility of loss arising from a defective title to the real estate, the buyers of such property can make a title insurance with the insurance company.

Burglary insurance—Burglary insurance is made in respect of movable goods by the owner with a view to providing against their loss by theft or robbery. Burglary insurance in respect of private dwelling houses covers the risk of loss by burglary, house-breaking and larceny, whereas in respect of business premises the risk of loss by burglary and house-breaking only is covered.

LLOYD'S ORGANIZATION

Lloyd's is a great name in the insurance world. Starting its career from Edward Lloyd's coffee house in the late 17th century, Lloyd's coffee house became the principal centre of underwriting business and of intelligence about shipping movements by the middle of the 18th century. Originally confined to marine insurance business only, it has developed during the last sixty years a world-wide market for all types of insurance business, except life assurance. Lloyd's maintains a global organization for the collection and diffusion of shipping intelligence.

Lloyd's is an incorporated society of underwriters in London. Underwriters do not accept business directly from the public, but must

transact business through Lloyd's brokers in London who are connected with Lloyd's either as members or subscribers. The underwriters form themselves into several syndicates which specialize in particular branches of insurance. Each syndicate appoints an agent who is empowered to accept risks on behalf of underwriters and to control other aspects of business. The interests of a Lloyd's policy-holder are safeguarded in two ways : (*a*) every underwriter has unlimited liability for his underwriting debts and is required to lodge security, and (*b*) the entire premium is placed in a trust fund to be used for underwriting liabilities.

CHAPTER 29

TRANSPORTATION AND TRAFFIC SERVICES

FUNCTIONS OF TRANSPORT

Transport provides the means of carrying goods and passengers from one place to another. In marketing, transport discharges an important function, since the entire work of assembling and dispersing of goods is done with the help of some forms of transport. Transport imparts place utility to goods by moving them from different centres of production to the places of consumption. Goods are now produced thousands of miles away from places where the consumer resides. Nevertheless, a marvellous transport system has ensured a steady flow of goods to the consumer within his easy access. Not only does it give place utility, but it also renders time utility in various ways. With the improvement in speed, transit time in transport has been shortened to a great extent, thereby increasing the turnover of capital and products of the business and preventing the risk of price changes.

Transport is the cause and effect of the industrial growth of a country. Better transport opens new markets which, in turn, increase the volume of production requiring the support of wider and larger transport facilities. It aids the physical production by carrying necessary materials to localized production centres and distributes the goods when they are fabricated into finished products. Without the development of transport, large-scale production would have been impossible. It is assigned such an important place in national economy that the progress of a country is frequently measured in terms of transport mileage. The social, political and economic advancement of the country is dependent upon transport. It has increased the variety and quantity of goods, reduced the price of products and quickened the time of their production and distribution.

MODES OF TRANSPORT

There are several means of transport which may be placed under three heads : (*a*) land transport, (*b*) water transport and (*c*) air transport. Water transport comprises inland and foreign shipping. Air transport was confined so long to the carrying of passengers, but gradually it is making headway as a carrier of goods. The comparative efficiency of the different forms of transport is judged with reference to the transport service and its cost. Service facility is dependent upon

a large number of factors which can be better appreciated by studying the advantages and disadvantages of each form of transport.

Motor Transport. With the advent of motor trucks, slow-moving vehicles and pack animals as carriers of goods have been largely eliminated. Motor transport is far superior to those primitive forms of land transport, and it has several advantages over its close rival—railway transport. (1) It renders complete service by loading goods at the consignor's place of business and unloading them at the door of the consignee. (2) For comparatively short distances, motor transport is speedier as well as cheaper than rail service. (3) It offers a greater flexibility in the adjustment of its services as to time and load factors. It can be loaded at night for early morning delivery without causing inconvenience to either party. As it has no scheduled time like the railways, truck service can be adjusted according to requirements. Further, the truck can commence journey with varying quantities of goods, and it need not wait for the wagon-load shipment, as required in the case of railways. (4) Truck shipments require less packing or even no packing in some cases. Both loading and unloading can be done at shorter time and expense as compared to the railways. (5) Goods carried by trucks are less liable to loss and damage, particularly in the case of fragile and perishable goods. (6) Because of the simple classification of goods and their traffic rates, the truck charges can be determined more easily than in the case of complicated railway rates.

The main disadvantages of motor transport are : (*a*) it is less reliable because of the possible breakdowns or road congestions ; (*b*) its rates are not stable in character and may vary between periods, or between concerns ; (*c*) lack of time schedule makes it less dependable, and as a result, delays often arise in transit and at terminals ; (*d*) goods are not adequately protected against total loss or destruction, and the truck owner or driver cannot be held fully responsible ; and (*e*) for long and heavy hauls, it is a poor substitute for railways.

Railways. Although the railway transport has lost ground to motor truck in respect of short hauls it retains its superiority in the movement of bulky and long-distance traffic. The railway offers five distinct advantages : *First*, it is capable of running long distance at high speed and is the only choice for long hauls in land transport. *Secondly*, small power requirement makes the railway a cheaper form of transport for carrying heavy goods to any great distance. *Thirdly*, the railway has the power of handling larger volumes of traffic by adjusting the number of wagons. *Fourthly*, it is not obstructed by weather conditions and provides a more dependable service. *Lastly*, goods are more safe and

secured against total loss, and the railway receipt, being a document of title to the goods, gives rise to some privileges during transit time.

The requirements of large initial investments and the relative inflexibility of the railways are the two great disadvantages. If sufficient traffic is not available after the railway track has been laid, it cannot adapt to changing conditions ; and the invested capital results in wastage of resources. Loading and unloading work as well as shunting and assembling of wagons take disproportionately long time. Cost of terminal operations becomes prohibitive in the case of short journey. In order to meet the competition of truck transport, railways have been forced in some cases to maintain delivery vans for making factory pickups and giving delivery at the consignees' door.

Water Transport. In foreign shipping, water transport is indispensable owing to the absence of road or rail connections between countries. The reason for this indispensability is that air transport is not feasible for the movement of bulky goods. In the case of inland water transport, however, the cheaper cost of transport is the dominant advantage in its favour. Against this advantage, there are a number of disadvantages of which the important are : (*a*) because of its slow speed, water transport is limited to those cases where time is not an important consideration ; (*b*) waterways may not be navigable due to various reasons ; (*c*) it serves a limited area, and goods must be available at certain fixed points ; and (*d*) goods may not be preserved against deterioration.

Air Transport. Air transport is emerging as an important carrier for the movement of light and costly goods. Originally confined to the carrying of passengers, it has recently made large inroads into freight traffic. Introduction of large-sized cargo planes and economy in the operating cost have enabled it to go in for untrodden and untractable paths. It has reduced the time and distance barriers between States or countries and has made the world shorter today than it was in the past. Air transport has three unrivalled advantages. (1) It adopts the most direct and the shortest route for carrying goods, since planes can fly over seas, deserts, jungles and mountains. Planes can reach those places which are not accessible to other forms of transport. (2) Where speed of transport is essential and time is valuable, it offers the only choice. (3) Its unsurpassed capacity to give quick delivery has resulted in the reduction of actual transport cost in several ways. The higher cost of transport is neutralised to some extent by the benefits of increased turnover, reduced inventory, diminished storing cost and expanded market.

Two serious disadvantages are the risks of plane crash and of unfavourable weather conditions for undertaking flight. Because of the

comparatively higher cost of transport, air transport can never compete with other forms of transport for carrying bulky goods, particularly those which are of small value. But for the movement of valuable, perishable and emergency goods, air service is finding wider application day by day. Fruits, tea, drugs and valuable machinery parts are being carried by the planes on an ever-increasing scale.

Pipelines. A significant means of transport in the field of liquid petroleum products, natural gas or coal gas is the pipeline. For transporting petroleum products from wells to refineries and from refineries to consuming areas, pipelines cost about one-fourth of that of railways. In other words, where the volume of traffic warrants, the pipelines are much economical for carrying oil from one place to another. Although waterways cost less than pipelines for carrying oil, absence of navigable canals and rivers limits the use of water transport in many cases. As regards gas, the pipelines provide the only feasible means of transport. Pipelines are being laid in our country for carrying crude oil and coal gas. For carrying oil, there are four major pipeline systems in the country, viz. Gauhati to Siliguri, Barauni to Kanpur, Barauni to Haldia and Koyali to Sabarmati. For transporting coal gas from Durgapur to Calcutta, the Government of West Bengal has laid pipelines.

THE INDIAN RAILWAYS

Development. From a modest beginning of 32 kilometres of railway line between Bombay and Thana in April 1853, the country has been covered today with a network of railway extending to about 60 thousand kms. Between 1854 and 1860, eight railway companies were formed for constructing railway lines with Government assistance by way of having free land and guaranteed interest of 5 per cent on capital investments. On the whole, the period up to the year 1900 was of uneven progress and the Government had to incur a loss of Rs. 58 crores on account of the guarantee system of railway construction. The development of railways took a new turn after 1900 and railways proved to be a source of gain on the part of the Government. The railway kilometrage increased from 39,603 in 1900 to 61,232 in 1925 and to 65,850 in 1939.

During the World War I, the Indian railways were on the verge of collapse and the defects of company ownership and management were brought to the forefront of railway problems. On the recommendations of the Acworth Committee in 1921, the replacement of company ownership and management by State ownership and State management of railways in India was commenced from the twenties of this century, and the railway finances were separated from the general finances in

1924. Subsequently, the railways in India were seriously affected by the depression of the thirties, by the World War II and by the partition of the country in 1947. During the war period, about 4,000 kms. of railway lines were dismantled and sent to war theatres in other countries. In addition, strategic lines totalling about 11,000 kms. went over to Pakistan after partition.

Since the independence of the country, vigorous attempts are being made by the Government to consolidate and expand the railways in tune with rapidly increasing process of industrialization. For consolidating the railways into one integrated system under the overall control of a central authority, railways were regrouped originally into six zones and subsequently into nine zones, viz., Northern Railway, Western Railway, Central Railway, Southern Railway, Eastern Railway, North Eastern Railway, South Eastern Railway (an offshoot of Eastern Railway), North East Frontier Railway (a part of North Eastern Railway) and South Central Railway. The rate and fare structure was rationalized by introducing uniformities and removing anomalies in all zones of the railway system. The backlog of arrears in maintenance and replacement of rolling stock and permanent way that accumulated over the past two decades was completed within the First Plan period. While the First Plan contained programmes of railway rehabilitation, the Second and Third Plans were intended for making progress on the part of railways. During the Second Plan, the targets comprised electrification of 1,322 kms., construction of 1,347 kms. of new lines, doubling of 2,571 kms. of track and the attainment of self-sufficiency in the production of locomotives and coaches. The Third Plan programme included provisions for electrification of 2,400 kms., opening new lines of 2,400 kms., and doubling lines of 3,548 kms. The Fourth Plan provided for dieselisation from 19,200 kms. in 1968-69 to about 22,000 kms. in 1973-74, electrification from 2,900 kms. to about 4,600 kms. in 1973-74, conversion of 1,500 kms. of metre gauge lines into broad gauge lines and doubling of 1,800 kms. of track. The railways in India at the present time are almost entirely owned and managed by the State. The total route kilometrage of All Indian Railways stood at 59,553 at the end of 1968-69.

For exercising supervision and control over the railways in India, a separate Railway Board with 3 members was created in the year 1905 and was placed under the Department of Commerce and Industry. The make-up of the Railway Board was changed in 1922 when the divisional system of administration was first introduced in the working of railways in India. The Railway Board was staffed by a Chief Commissioner as president of the board, a financial commissioner as well as by three other commissioners. After independence, the post of the Chief Commissioner was abolished in 1951 and the Railway Board was placed under the

overall control of the newly formed Railway Ministry. At present, the Board is constituted by three functional members, one financial member, and the secretary of the Transport Ministry as an *ex officio* member. Furthermore, for settling disputes in matters of railway rates, the Railway Rates Tribunal has been set up in April 1949, in replacement of the old Railway Rates Committee.

Nationalization. Railways being public utility concerns, they are placed under Government control in some form or another in all countries of the world. Nationalization, however, implies assumption of full control by the State through the acquisition of ownership rights. Railways in India today are nationalized enterprises ; but this nationalization has been effected after much waiting and insistent public demand. For the first 20 years from 1849 to 1869, railways were constructed, owned and managed by private enterprises. During the next twelve years from 1869 to 1881, railways were constructed by the State and managed by private enterprises. From 1881 onwards to the period of World War I, the railway construction was entrusted in the hands of private enterprises under revised guarantee system. As a result of these shifting policies, railway administration was characterised by weaknesses and lack of judgement or imagination. The Acworth Committee made a strong case in its report in 1921 for replacing company management of railways by State management thereof. Accordingly, the Government took over management of the East Indian and the Great Indian Peninsular Railways in 1925. In course of time, direct control over other railways was taken in the hands of the Government.

The arguments for nationalization were based on a number of considerations. *First*, the Government guarantee of interest on capital investments led to extravagance on the part of private companies ; consequently, it resulted in poor operating efficiency. For improving efficiency and effecting economy in the working of railways, nationalization was found to be the only remedy. *Secondly*, ownership investments of companies in railways was as low as 5% of the total investments and the overwhelming part of capital investment was raised by the State. This control over large capital investments without any corresponding financial stake created the conditions for irresponsible management ; as a result, replacement and maintenance were neglected. *Thirdly*, at a time when the railways began to earn revenues, the companies were guided by commercial motives without having any regard for interests of passengers and business houses. It was pointed out that State management alone could provide cheaper rates in fares and freight charges, better facilities, and more equitable and uniform treatment to all throughout the country. *Fourthly*, transport development and co-ordination were dependent upon the planned construction and operation of

railways, since railways were the principal carrier of goods in the country. With this end in view, there was no alternative to State ownership and management of railways. *Finally,* the operation of railways was not conducive to the growth of Indian trade and industry. Railway companies were loosely controlled by the Railway Board with headquarters in London for the first few years and were influenced more by the European merchants rather than by the Indian merchants. Accordingly, it was held that no measure which fell short of complete State ownership and management could cure this evil.

Fixation of Rates. The fixation of railway rates had been a matter of contention from the very commencement. Under the company system of management, varying rates were charged for the same goods traffic by different railways. Efforts were made, however, towards the beginning of the present century to introduce a uniform rate through the common classification of goods by the appointment of a Goods Classification Committee. The first classification of goods for charging uniform freight rates on the Indian railways came into force from July 1910, and this classification of goods was revised from time to time up to the year 1922 when a new classification was adopted. On the recommendations of the Acworth Committee, this new classification divided the goods carried by the railways into ten classes, thereby increasing the number of classes from five to ten and enhancing their maximum rates. From 1936 onwards, a new classification was again introduced ; and under this classification, goods were divided into sixteen effective classes.

After the achievement of independence, a new classification of goods was introduced from October 1949, as recommended by the Railway Rates Advisory Committee. According to this classification goods were divided into 15 classes and the railway rates into 3 classes. On the recommendations of the Railway Freight Structure Enquiry Committee, another classification has been adopted from October 1958. According to this classification, goods have been divided into 24 classes for standard telescopic rates in respect of smalls and 31 classes for standard telescopic wagon load rates in respect of wagon loads with special rates for coal, coke and fuel. As regards the nature of traffic, thousands of goods with varying sizes, shapes or values have been divided into 55 classes in such a way that each class comprised a large family of goods. This classification of goods is based upon a number of considerations like the kind and value of goods, the regularity of consignments and the total traffic during a period, the degree of risk involved in transit, the bulk of goods in proportion to weight, the use of open, closed or special-purpose wagons, the requirement of fast moving service for perishables and other products, etc. For some common class of goods, there are separate rates for 'smalls' and 'wagon loads'.

The term "smalls" implies consignments weighing less than four quintals. The wagon indicates a four-wheeled car, while the charge for a six-wheeled car is 1½ times the wagon rate and the charge for a bogie is double the wagon rate. All goods pertaining to smalls group are carried at railway's risk and goods pertaining to wagon loads group are carried at owner's risk. If the latter goods are to be carried at railway risk, they are liable to 20 per cent additional freight charge. In addition to the class rates, there is the station-to-station rate. Station-to-station rate is charged for a distance between two stations only and has been kept lower than class rate for meeting competition from other means of transport. Special reduced rates have been fixed for coal, coke and fuel which are not included in any class of goods.

Basis of Rates. The railway rates in India have been fixed on the basis of some universal principles of rate fixation. The important principles, or theories as they are called, of rate fixation may be stated as follows :

1. *Cost of service principle*—The railway rates and fares being the prices charged for rendering traffic services must cover the total cost of railway operation. Selling the service at a price below the cost of operation is not practicable over a long period in the business world. Like other goods and service, pricing is to be effected on the basis of the total cost of operation. This principle seems to be obvious and appears logical at the first sight ; but there are some peculiarities of railway operation that have limited the application of the cost of service principle in determining rates. *First,* determination of unit cost for carrying a particular traffic is an impossibility in the case of railways. Railway costs are composed predominantly of overhead or common expenses, the other part being the special, direct or out-of-pocket expenses. Expenses on tracks, signalling devices, running and office staff or the like of them belong to the group of overhead expenses and are common for both passenger and goods traffic. Again, thousands of goods of varying sizes or shapes are carried by the railways and such goods are, to say the least, absolutely non-standardized in character. As a result, common expenses cannot be allocated to different kinds of traffic on a basis of certainty. Special expenses can, however, be allocated approximately to a particular traffic in many cases. *Secondly,* cost allocation implies an estimate of the probable volume of traffic during a period. Volume of traffic cannot be ascertained beforehand and is rather dependent upon the fixation of favourable rates. Production volume of manufacturing enterprises can be planned and their products can be stored for future consumption. In contrast, the railway service cannot be stored for future consumption and is lost forever if such service is not utilized at the time of its creation. *Thirdly,* because of their mounting overhead

expenses and of their perishable nature of services, railways are forced to reduce their service charge as low as the capacity of a particular traffic warrants. Otherwise, it leads to the diversion of railway traffic to truck lines or other means of transport, and thereby reducing the total volume of railway traffic further. *Finally,* railway rates are important determinants of the production cost and the marketing cost in the case of other business enterprises. For the development of trade and industry in a country, railway rates are required to be reasonable, irrespective of the cost of railway operation. Many mineral and natural resources are located in specified regions of the country. Unless the railways offer specially reduced rates for carrying such resources to different parts of the country, the prosperity of the nation is halted.

Despite these limitations of the cost of service principle, it is used everywhere in the fixation of the scale of railway rates. .Cost of operation is a vital question to the railway companies and controls the potential supply of railway service. The cost of service principle determines the lowest limit of railway rates in different cases. That minimum limit of railway rates is furnished by the amount of special or out-of-pocket expenses incurred for any particular traffic. Moreover, the cost of service principle helps in fixing the general level of traffic charges in such a way that the total revenues are sufficient to cover all expenses. For the fixation of general level of charges, however, rate differentials between two kinds of goods traffic are to be ascertained first of all. Consequently, the cost of service principle determines the minimum charges, the general level of charges as well as the rate differentials to some extent.

2. *Value of service principle*—The value of service principle calls for the determination of railway rates from the demand side of railway service. Railways add place utilities to goods through their movement from one place to another. And the amount of place utilities can be measured in terms of money by the extent of price difference prevailing between two regions in the case of same goods. Normally, the value of railway service is taken to be what it adds to the price of any goods through their carrying from one place to another. No doubt the value of service principle provides some guides to the fixation of railway rates, but it cannot serve as a sole or self-exclusive criterion of rate fixation for three reasons. *First,* the demand for railway service is a derived one from the demand for other services and goods. Except some goods of inelastic demand, the prices of goods vary with the state of demand which, in turn, affects the value of service. As a result, the railway rates based on the value of service are required to be changed every now and then. *Secondly,* the service of movement is provided by several means of transport in addition to railways. For example, the truck lines have appeared as a menace to the railways in many countries of the world. Accordingly, the value of railway service is determined by the total

demand for, and supply of transport facilities. Furthermore, the value of service is determined not only by the distance of traffic, but also by the rapidity and efficiency with which the traffic is handled. *Thirdly*, railways are public utility concerns, and they are given monopolistic rights of operation through a franchise. Because of this situation, railway rates are regulated by the State for the furtherance of public welfare. In regulating the rates of public utility concerns, rates are fixed at such a level that should cover the total cost of operation plus some return on investments ; and the demand for service is ignored as a matter of guidance. Subject to the limitations of the value of service principle, it helps a lot in fixing the maximum rate for each kind of traffic and in allocating the common expenses on the overall traffic by way of maintaining differential charges.

3. *Charging what the traffic will bear*—Railway rates are mostly fixed on the principle of charging what the traffic will bear. While the cost of service can be of help in determining the minimum rate and the value of service in determining the maximum rate, the actual rates within the two extreme limits are fixed on the trial-and-error method for maximizing railway revenues. The practice of charging what the traffic will bear is an offshoot of the value of service principle, but makes strategic reduction in rate charging for meeting competition from other means of transport, for encouraging traffic in low-priced goods of great bulk, or for utilizing the full installed capacity of the railway. In other words, the system of charging what the traffic will bear is based on the common maxim of pricing—rates must be high enough to cover all costs of operation, but low enough to attract passenger and freight traffic. Under this principle, low-priced goods, like coal, coke, fuel, etc., are charged at a rate that covers hardly the out-of-pocket expenses, medium-priced goods like raw materials, minerals, foodgrains, oilseeds, etc., are charged at a higher rate for covering the out-of-pocket expenses plus as much part of the common expenses as possible, and high-priced goods like finished products, machines, raw silk, etc., are charged at the highest rate for covering all deficiencies between total costs and total revenues in respect of goods traffic.

The system of charging what the traffic will bear conforms to the ability theory of taxation and makes a wide discrimination between two rates charged on differing goods. In the past, this system of charging rates was abused by way of encouraging exports of raw materials and minerals from the country and of promoting imports of foreign goods into the country. If properly administered, this system of rate charging may appear as a boon for securing an orderly and balanced development of all regions of the country.

4. *Other principles*—The other bases for rate determination include the flat rate principle, the telescopic rate principle and the

principle of zonal charging. The flat rate principle calls for charging the rate on the basis of kilometrage travelled. The telescopic rate principle is based on tapering rates under which the rate per kilometre decreases as kilometrage increases. The principle of zonal charging calls for dividing the area served by a railway into several zones and making the same charges in one zone irrespective of the distance travelled.

Rail-road Competition and Co-ordination. In recent years, the truck lines have made large inroads into the railway traffic throughout the world. With huge investments of sunk and permanent nature in tracks, signalling devices, rolling stocks and other like items on the part of railways, this competition between two principal means of land transport has become ruinous for railways. Diversion of railway traffic to truck lines increases the average cost of railway services, thereby causing enhancement of railway rates and further diversion of railway traffic. As regards the extent of competition, the Survey Report of the British Ministry of Transport in 1958 indicates that motor transport accounts for 56% of the total over-the-land traffic in the U.K., 69% in Italy and 52% in Australia.

For small-sized shipments and short distance traffic, truck lines are far superior to railways. And in the case of large-sized consignments and long distance traffic, railways have inherent superiority. As a result, the cream of the goods traffic is taken away by truck lines, leaving the railways to handle goods that fall under the group of lower class rates. Being deprived of goods traffic pertaining to higher class rates, the railway operation becomes unprofitable and hazardous in character. In our country too, many business enterprises are using railway services for the movement of raw materials, minerals and agricultural produce, while movement of finished products is being effected on an expanding scale by truck lines. The reasons for this greater reliance on road transport are (*a*) reduction in transit time to about 25% of that of the railways, thereby increasing the rate of working capital turnover and preventing funds from being tied up during the larger railway transit period ; (*b*) packing costs are much higher in the case of railways in comparison with road transport ; (*c*) petty pilferage and loss of goods are so common in railways that they do not justify the expenditure of time and energy in putting numerous claims with the railway authorities ; and (*d*) the truck lines offer door-to-door service which is wanting in the case of railways. The business community in England has voiced a similar distrust in the railway service through its representation before the Stadford Committee in 1960 to the effect that railway lines should be scrapped and replaced by truck lines as far as practicable, because railways are inefficient and uneconomical in matters of traffic services.

In spite of all failings, railways are essential for the economic development of a country, particularly so in the case of India where transport facilities are still inadequate. From the political and social points of view also, there is much to commend in support of the railways. No matter how important may be the role of railways, a country cannot dispense with the services of truck lines. Unfortunately for India, truck lines have not been allowed to grow in proportion to the development of railways. Three great handicaps which have arrested the growth of road transport are (*a*) unfavourable policy of the Government as expressed through heavy taxation on truck lines and restrictive provisions of the Motor Vehicles Act, (*b*) slow progress in the construction of roads, and (*c*) belated start of automobile industry for manufacturing motor vehicles. As a result, rail-road competition in India at the present time has become a matter of past history or of future proposition. But days are not far off when this competition is bound to appear with all seriousness, as it is to be found in the case of other countries. Once the road kilometrage is increased substantially and the vehicles in requisite numbers from the automobile industry start rolling out, the nationalized railways would have to face tough competition from the truck lines.

Means of Co-ordination. Since rail-road competition is undesirable from all points of view, such competition is suspended by securing co-ordination in the operation of both railways and truck lines. Some important means of rail-road co-ordination may be stated as follows :

1. Since truck and bus lines can ply on local, regional or national highways, the construction of roads has a significant influence on the extent of competition between railways and road transport. As a rule, roads that may run parallel to main railway lines should not be built ; road construction as feeder lines to railways or for areas not served by railways should be given priority.
2. Despite the exercise of common control over the railways in India, they have not been integrated into one system. In actual practice, there are three different systems of railways, viz., broad-gauge, metre-gauge and narrow-gauge railways which prevent interconnection and through running of traffic services. While the broad-gauge lines work to their full capacity, metre- and narrow-gauge lines suffer for the diversion of traffic to motor transport, Wherever practicable, both metre-gauge and narrow-gauge lines are to be replaced by broad-gauge lines.
3. It is contended by some that rail-road co-ordination can be secured by way of regulating motor transport through heavy taxation and the issuance of operating permits or licences. Such regulatory measures have been attempted in other countries but

they have not proved to be effective. In our country too, each freight or passenger vehicle pays now as much as Rs. 2,600 per annum by way of various taxes and duties. The issue of licences has also been tightened under the Motor Vehicles Act. Because of these regulations, the choice of traffic users has been curtailed and the growth of motor transport hindered. Briefly, this means of co-ordination appears to be an outdated one at the present time.

4. Another radical means of co-ordination is to effect nationalization of road transport. Nationalization of road transport has been effected by several State Governments in the sphere of passenger services. In addition to the bus lines, some State Governments have contemplation to nationalize the truck lines as well. The usual arguments for nationalization are based on certain advantages like (*a*) introduction of efficient and cheaper transport system, (*b*) standardization in the schedule of rates and fares throughout the country, (*c*) extension of transport facilities to all parts of the country, and (*d*) assurance of proper road development and maintenance. Arguments against nationalization include (1) loss of private initiative or enterprise and growth of oligopoly in the sphere of land transport, (2) absence of flexibility in operation of passenger or truck lines, (3) managerial difficulties in the running of services, and (4) excessive costs through the loss of revenues and the payment of compensation. However, passengers have become dissatisfied with the operation of State transport services, and further nationalization is perhaps not justified at the present time. Furthermore, there is lack of co-ordination between the State Transport Authorities and the Railway Authorities. And it becomes a pointer to the fact that rail-road co-ordination may not be secured through nationalization of all motor transport services.

Road Development in India. The Nagpur Plan contemplated in 1943 a 20-year road development programme for constructing 6,88,000 kms. of roads comprising National Highways, State Highways, Major and Minor District Roads and Village Roads. Owing to the partition of the country in 1947, the proposed kilometrage of roads was reduced to 5, 29,600 kms. comprising 1,96,800 kms. of surfaced roads and 3,32,800 kms. of earth roads. The Committee of Chief Engineers submitted in 1958 a 20-year Road Development Plan (1961-81) for constructing 10,51,200 kms. of roads comprising Express Ways, State Highways, District Roads and Village roads. At the end of the Fourth Plan, the length of surfaced roads was expected to reach 3,85,000 kms.

Moreover, the Border Roads Development Board established in 1960 was expected to construct 6,900 kms. of new roads and to improve 4,700 kms. of existing roads.

SHIPPING LINES IN INDIA

Growth. Importance of shipping lines can hardly be stressed for a country with a coast line of more than 3,500 miles and a sizeable amount of overseas trade. Nevertheless growth of Indian shipping has practically started with the formation of the Scindia Steam Navigation Company in 1920. Earlier attempts towards establishing Indian shipping lines were foiled by the British shipping interests with the support of the foreign Government. Even the Scindia Company had to pass many trials and tribulations for its existence during the pre-independence period in view of ruthless competition from the British shipping companies and of the unfavourable attitude of the Government. In 1922 the British India Steam Navigation Company tried unsuccessfully to extinguish the Scindia Company through its outright purchase. The Scindia Company was, however, granted the privilege of using 75,000 tons of ships in the coastal trade in 1924 and of increasing the tonnage capacity to 100,000 tons in 1933, the operation of foreign trade remaining the close preserve of the British India Steam Navigation Company throughout the period of foreign domination. From 1947 onwards, the Scindia Steam Navigation Company has extended its operations to the U.S.A., the U.K. and other countries in the sphere of both passenger and cargo-services.

The Mercantile Marine Committee was appointed by the Government in 1923, and the Committee made certain important recommendations like reservation of coastal trade for Indian ships, financial assistance to the Indian companies, training arrangements for Indians in marine engineering, etc. Of all these recommendations, the one for training only was accepted by the Government and the training ship "Dufferin" was acquired in 1927. A Shipping Policy Committee was appointed in 1944 and the Committee submitted its report in 1947 with some valuable recommendations which have been accepted and are being made effective by the Government of India. According to this shipping policy, the National Shipping Board has been established under the chairmanship of a Director General of Shipping. The Government has participated in the shipping business by way of contributing share capital to shipping corporations and giving financial assistance to others for the rapid growth of Indian shipping. The Government purchased the controlling shares in the Eastern Shipping Corporation Ltd., which came into existence in 1950. Another shipping corporation was established in June 1956 under the name of the Western Shipping

Corporation Ltd., and it was entirely owned, operated and controlled by the Government. These two shipping corporations have, however, been amalgamated in October 1961 and have taken the name of the Shipping Corporation of India Ltd. with an authorised capital of Rs. 35 crores and a paid-up capital of Rs. 23 crores. Other measures for the development of Indian shipping include the establishment of one Nautical and Engineering College in Bombay and two Marine Engineering Colleges in Bombay and Calcutta as well as the expansion of shipbuilding yard at Visakhapatnam to a capacity of 90,000 gross registered tons. Furthermore, all the six major ports and about 200 intermediate or minor ports are being developed under the five-year plans.

As regards shipping tonnage, the Shipping Policy Committee recommended in 1947 for the acquisition of 2 million tons of shipping capacity within the next five to seven years. The capacity of Indian shipping was 100,000 gross registered tons (G.R.T.) in 1946 and it rose to 3,62,150 G.R.T. in 1950. The targets of shipping capacity for First and Second Plans were 6,00,000 G.R.T. and 900,000 G. R. T. respectively. The shipping tonnage reached the level of 21.4 lakh G.R.T. by the end of 1968-69. It was made up of 18.0 lakh G.R.T. of overseas shipping and 3.4 lakh G.R.T. of coastal shipping. The Fourth Plan provided for raising the shipping tonnage to 35.0 lakh G.R.T. consisting of 31.0 lakh G.R.T. of overseas tonnage and 4 lakh G.R.T. of coastal tonnage. By the end of the Fourth Plan, Indian shipping was expected to carry about 40 per cent of the country's overseas trade.

Nationalization. The case for nationalization of transport facilities appears to be weakest in the sphere of shipping lines. In Great Britain, railways, airways, motor transport and canal transport have been nationalized, but the Government of that country has not dared to nationalize shipping lines for the difficulties of operation and management. The proponents of nationalization point out that there exist some special considerations in the case of Indian shipping. *First,* since a powerful mercantile marine can serve as a second line of defence, the Government should take over the shipping business for ensuring its rapid and adequate development. During the war period, mercantile marine is utilized for naval purposes in all countries of the world ; and for this, nationalization is not at all warranted. *Secondly,* shipping competition is so serious between lines of different countries that Indian shipping cannot survive such devastating international competition. Competitive strength lies not only in the amount of financial resources at the disposal of shipowners, but in the operating efficiency of lines as well. As regards operating efficiency of shipping lines, State-owned shipping companies cannot attain the standard that can be reached by the private enterprise. To withstand unfair foreign competition, subsidies and bounties are

usually paid to the shipping companies by the Government of all nations. Nationalization cannot cure the evils of shipping competition, rather it may magnify the extent of such competition. *Thirdly,* the development of ports and shipbuilding industry can become thorough and satisfactory only when the entire shipping business is taken over by the Government. No doubt, development of ports and shipbuilding industry is an urgent necessity for the growth of shipping lines ; but Government control over the one aspect does not call for any control over the other, and they can be separated without losing the operating efficiency of either.

The shipping policy formulated in 1947 calls for Government participation in the shipping business by way of establishing mixed-ownership companies. Accordingly, the Eastern Shipping Corporation was set up by the Government in collaboration with private enterprises. But in the formation of the Western Shipping Corporation by the State alone, this policy was reversed. Besides this shifting policy in regard to ownership of shipping corporations, another confusion was created by the operation of tanker service in the coastal trade on the part of the State-owned Western Shipping Corporation. Consistent policies and clear-cut jurisdictions of operation seem to be essential for the orderly expansion of Indian shipping.

Shipping Competition and Co-operation. Shipping competition is characterized by such intensity that it has no parallel in the business world. The reasons for this fierce, cut-throat and destructive competition can be traced in the following factors :

First, shipping business deals in services which cannot be stored for future consumption. Once the services are created through the building of ships at a huge cost, such services are to be sold at any rate. If services are not utilized, they are lost for ever. To minimize the amount of loss, shipping companies are compelled to sell their services at any price that could be secured rather than keeping the ships idle, and thus losing the total cost of service. Furthermore, the cost of creating services varies widely according to the design of ships. For using different motive power, ships are designed as *sailing ships, barges as well as those vessels which are driven by coal, steam, diesel oil or electricity.* The same tonnage capacity is built at widely differing costs in the case of these different types of ships.

Secondly, shipping services are rendered by carriers on different bases which account for unequal competition between ships. As regards the basis of service, ships fall into *tramps and liners.* Tramps are cargo freighters which have no fixed route of plying and no fixed time of sailing. Tramps can go to any place wherever cargoes are available. The operating cost of tramp service is comparatively much lower, but tramps

move at a slow speed. Liners, on the other hand, are meant for carrying passengers as well as cargoes. Liners ply on fixed routes with fixed timings, and they are larger, faster and more expensive ships than the tramps. Liners may be subdivided into *express liners* for carrying mails, passengers or costly freight, *cargo liners* for moving goods of diverse types and *combined liners* for carrying both passengers and cargoes.

Thirdly, ocean transport is open to all ships of different nationalities and is free from State regulations in the free water of high seas. As a result, shipping competition becomes international in character among the shipowners with different capital resources, organizing abilities and Government subsidies or bounties.

The only way out for this severe competition has been found in fostering co-operation among the shipping lines and in effecting some loose form of combination among them. The usual practices of eliminating or reducing competition are as follows :

1. *Shipping conference*—For avoiding or restricting competition, many shipping lines form combination among themselves through the formation of shipping rings or conferences. The object of shipping conference is to regulate the traffic on one or more routes among the members by way of fixing sailing times, determining minimum rates, adopting specialization in the handling of traffic or other like means. Shipping conferences lead to the conclusion of agreements, whether formal or informal, among the shipping lines, for limiting their freedom of action in respect of one or more aspects of their operation for the common benefit of the group. For other aspects not covered by the agreement, conference members are free to behave in any way they like. Moreover, one shipping line may join several conferences at the same time. When shipping conferences are organized into a well-knit body, shippers are exploited through higher charges on the principle of "what the traffic will bear". Non-member shipping companies have the danger of being forced out of existence by rate-cutting through a freight war.
2. *Pooling agreement*—Shipping companies may also enter into pooling agreements whereby they can suspend competition. Pooling agreements take two forms—income or money pools and traffic pools. Under money pools, total earnings of all members are pooled to a common fund to be divided among members in a certain agreed proportion after meeting members' operational expenses therefrom. Traffic pools call for the division of the entire traffic among members by way of allocating quotas of traffic, assigning areas of operation or prescribing routes of sailing.

3. *Deferred rebate*—To ward off competition from non-member shipping lines, shipping conferences indulge in the practice of allowing deferred rebate to those shippers who give continuous full support to the conference lines. That is, while conferences are meant for eliminating competition among the members themselves, deferred rebate is designed for rooting out competition between conference members and outsiders. Rebate is granted on the collected freight money over a period extending from 3 to 12 months, and the payment of rebate is delayed till the end of a subsequent period to ensure continuous support on the part of shippers. Rebate and future shipping service are denied to those shippers who rely on non-member shipping companies for sending cargoes. The amount of rebate varies from five to ten per cent of collected amount of freight charges.

Coastal Shipping. India has a coast line of more than 3,500 miles with six major ports at Bombay, Calcutta, Madras, Cochin, Visakhapatnam and Kandla and a number of smaller ports. From the defence as well as economic point of view, development of coastal shipping appears to be indispensable. Before the independence of the country, coastal trade was largely confined to the British shipping companies and Indian ships had a small share in the coastal shipping. Since the report of the Mercantile Marine Committee in 1923, several futile attempts were made for the reservation of coastal trade to Indian ships. In the report of the Shipping Policy Committee, this demand for reservation of coastal traffic was reiterated in 1947 and the Government decided to Indianise coastal shipping by August 15, 1951. Unfortunately, the foreign refineries have been allowed in subsequent years to run their own tanker services for the movement of petroleum products in the Indian coast. In addition, the State-owned Western Shipping Corporation was running tanker services in the coast. These inroads into the coastal traffic have affected the growth of Iidian shipping in the private sector to some extent.

Indian shipping can acquire stamina and maturity from operations in the coast line. Since overseas trade is associated with several difficulties and serious competition, Indian shipping lines cannot go in for overseas trade in all cases. But if they are allowed to gain experience, strength and maturity through their engagement in coastal shipping, extension of services to overseas trade becomes a matter of ordinary course. That is, reservation of coastal trade is the key to the growth of Indian shipping. Futhermore, the development of Indian ports, shipbuilding industry as well as of internal trade centres round the operation of coastal shipping. Accordingly, the Government is making serious efforts for the expansion of coastal shipping. The shipping tonnage

for coastal shipping was expected to increase from 3.4 lakh G.R.T. in 1968-69 to 4 lakh G.R.T. in 1973-74. Competition from the railways has arrested the proper growth of coastal shipping. As regards oil cargo in coastal trade, the share of Indian shipping was as low as 21.3 per cent in 1968.

AIRLINES IN INDIA

Evolution. Air services in India have practically commenced from the thirties of the century. After the establishment of a separate Civil Aviation Department in 1927, construction of aerodromes and organization of flying clubs were taken in hand, and the arrangement was made first with the Imperial Airways Ltd. to extend its service to New Delhi on December 30, 1929. Thereafter two Indian lines came into existence for operating internal services within the country, viz., the Tata Airways Ltd. in 1932 and the Indian National Airways Ltd. in 1933. The Indian Transcontinental Airways Ltd. was formed in 1933 through the joint participation in its share capital by the Imperial Airways (51%). Indian National Airways Ltd. (25%) and the Government of India (24%). This company operated the service between Karachi and Singapore so as to provide a link in the Empire Service from England to Australia. Another significant step in the growth of civil aviation was the initiation of the Empire Air Mail Scheme in 1938. Under the scheme, the distribution of mails throughout India was entrusted in the hands of two Indian companies—The Tata Airways Ltd. and the Indian National Airways Ltd. The Empire Air Mail Scheme was, however, suspended on the outbreak of war, again resumed in August 1945, and finally abandoned after March 1947.

The Second World War provided an opportunity to realize the importance of air services for defence purposes and to make rapid strides in the growth of airlines. The two Indian companies operated air services on 16 routes and earned handsome profits during the war period. The Government of India appointed a committee in 1944 under the chairmanship of Sir Mohammed Usman for making recommendations on policy questions with a view to securing an orderly development of Indian airlines. Sir Frederick Tymms, the Director General of Civil Aviation, made certain fruitful suggestions over the recommendations of the Usman Committee, and through such deliberations, the post-war reconstruction policy on civil aviation emerged in 1946. It was made clear in the policy that operation of air transport services would be subject to licences granted by the Government and without such a licence, no transport service would be allowed to operate. The policy specified that licence would be granted to a limited number of sound companies in the private sector for the operation of both

internal and external services. For the execution of the policy, the Air Transport Licensing Board was established in 1946. By the end of 1947, licences were granted to 11 airline companies which had authorized capital of Rs. 42 crores and which operated air services in 96 routes. During the year 1949, the Air India International was formed by the Government in collaboration with the Tata Sons Ltd. for operating external air services over all Western routes. The Tata Airways Ltd. was reorganized as Air India and it was appointed as technical manager of the Air India International. Licences were also granted to the Bharat Airways and the Indian Overseas Airlines to operate all external services in the East. Another innovation made in 1949 was the grant of licence for night mail service to the Indian Overseas Airlines.

The partition of the country in 1947 and the grant of too many licences to non-scheduled companies brought financial loss to all airline companies and resulted in the emergence of some uneconomic units. For improving the operational efficiency of airline companies, the Government of India appointed the Air Transport Enquiry Committee in 1950 under the chairmanship of Mr. Justice Rajadhyaksha for making suitable recommendation. Based on its findings, the Committee made certain recommendations as follows : (i) as the volume of air traffic warranted the operations of 4 companies, all the existing 11 companies should be integrated into four companies, (ii) external air services should be reorganized and placed under the control of one single agency, (iii) company investments in aircrafts were totally unrealistic and such bad investments were responsible for high operating cost. Outdated machines like Dakotas and Vikings should be replaced by modern machines, and external services should utilize jet aircrafts and Super Constellation aircrafts, (iv) wasteful competition should be eliminated by way of redistributing routes, preventing non-scheduled operators from flying on the routes of scheduled companies and fixing the minimum rate of charges on the part of non-scheduled operators, and (v) for improving the economic condition of companies, the number of aircrafts should be reduced, rates and fares should be enhanced, superfluous and excess capacity should be curtailed, and finally the Government assistance should be extended in the form of rebate of customs duty on petrol.

Nationalization. The question of nationalizing air transport was first considered at a conference held under the auspices of the Ministry of Communication in 1947. The arguments that were put forward at the conference in favour of nationalization included (1) utilization of aircrafts to their maximum capacity and avoidance of duplicate staff, workshops and other facilities, (2) improvement in operational efficiency through centralized management, (3) huge expenses of the State on

ground organization, communication system and pilots' training facilities, (4) contribution of air-service profits to the national exchequer, and (5) maintenance of reliable and efficient service from social, political and defence points of view. In contrast, the arguments against nationalization were based on a number of points like (*a*) loss of initiative, flexibility and individual enterprise in matters of operating air services, (*b*) unsatisfactory services due to poor motivation of operating staff arising from impersonal relationship between the Government and the employees, (*c*) negligence towards developing air transport which is deemed a luxury service by the public at large, (*d*) rise of evils associated with the absence of competition and the growth of monopolistic rights and (*e*) dearth of competent personnel required for technicalities and peculiarities of air service management.

Although the policy statement on civil aviation and the recommendation of the Air Transport Enquiry Committee were not in support of nationalization, the Government decided in 1953 to nationalize air transport. The steadily deteriorating condition of airline companies as revealed in their mounting losses, their inability to modernize aircrafts and their unwillingness to effect integration prompted the Government to take over air services under State ownership and State management. Nationalized air services have been organized under the two statutory corporations—the Air India (renamed from Air India International from June 1962) Corporation for external services and the Indian Airlines Corporation for internal services. Since nationalization, much improvement has been effected in matters of both service facilities and air traffic. The capacity of Indian Airlines Corporation was expected to rise from 208 million tonne-kilometres in 1968-69 to 392 million tonne-kilometres in 1973-74. The fleet strength of the Corporation would be raised during the Fourth Plan through an investment of Rs. 55 crores. Likewise, the capacity of Air India Corporation was expected to rise from 462 million tonne-kilometres in 1968-69 to 990 million tonne-kilometres in 1973-74. During the Fourth Plan, the Corporation was expected to introduce Jumbo jets or Boeing 747. At the end of March 1969, Indian Airlines Corporation had a fleet strength of 71 consisting of 7 Caravelles, 14 Viscounts, 15 Friendships, 8 HS—748 and 24 Dakotas. At the end of March 1969, the Air India Corporation had 10 Boeing jets. During the Fourth Plan, 3 additional Boeings 747 were proposed to be acquired.

TRAFFIC SERVICES

Movement of goods and material is effected both within and without the plant. Movement of materials within the plant involves activities that go by the name of "materials handling" and management

thereof comes under the work of "production control". But movement of materials or goods outside the plant is concerned with "traffic activities" and the management work in regard to such activities is known as "traffic management". Traffic activities call for a specialist knowledge on the part of the traffic manager who must be conversant with the facilities of different means of transport and their comparative rates. For effecting shipments economically and effectively, there remains a wide choice of carriers on the questions of safety, reliability, promptness and many other aspects of traffic services. Unless forwarding and clearing of goods are effected through specialized agents, the traffic activities are to meet the varying requirements of packing, marking, delivery and customs formalities. In addition, the traffic manager is to place the demand for compensation with the carrier in those cases where the goods are damaged or lost in transit and to settle the claims in accordance with the nature of carrier's liability for a particular consignment. As questions of liability are usually bound up with the terms of carriage contracts contained in the carriage documents, the traffic manager is to see that documents issued by carriers are in order.

Carriage Documents. The following are the documents issued by three important types of carriers :

Railway receipt—This receipt serves three purposes, viz., (*a*) it is a receipt issued by railways for the goods to be carried, (*b*) it is a voucher for the railway freight, and (*c*) it is a document of title to the consigned goods. Although the railway receipt is not a negotiable instrument, it can be transferred by endorsement for permitting the endorsee to take delivery of the goods on the basis of trade usage. When the railway receipt is issued in favour of the consignor, he alone becomes entitled to claim compensation from the railways and the consignee cannot bring a suit against the railways. But to facilitate the consignee to take delivery of the goods and to claim compensation, if any, on his own right, the railway receipt may also be issued in favour of the consignee.

Bill of lading—Like the railway receipt, the bill of lading serves three important purposes in marine transport, viz., a receipt for goods on board the ship, a contract of affreightment as well as a document of title to the shipped goods. The bill of lading contains a number of particulars like (1) the name of exporter and shipping line, (2) the name, nationality and type of ship, (3) the date and place of shipment, (4) the description, weight and value of cargoes, (5) the amount of freight paid or to be paid, and (6) the shipping company's undertaking to deliver the cargo in a fit condition at the port of destination. The bill of lading is usually prepared in several copies meant for consignor, consignee, banker, clearing agent, shipping line, etc. A bill of lading may be a "clean bill' or a "qualified bill" depending upon the statement

of particulars with or without qualifications. Sometimes a "through bill of lading" is issued for facilitating the onward journey of goods partly over the seas and partly over the land. The bill of lading being a quasi-negotiable instrument, it can be freely transferred by endorsement and delivery.

Consignment note—For the carriage of goods by air, the consignor secures an "air consignment note" which has much similarity with the bill of lading as required in the case of marine transport. The usual contents of a consignment note are (1) the place and date of issuing note, (2) the places of departure, destination and stops in transit, (3) the names and addresses of parties concerned like the consignor, the consignee and the carrier, (4) the description of goods and all particulars thereof regarding condition, quality, weight, volume or value, (5) the amount of freight paid or to be paid on delivery, and (6) the carrier's terms of carriage and liability thereunder. For the transport of passengers and their luggages by airlines, separate passenger tickets and baggage tickets are issued by the airline operators.

CHAPTER 30

ADVERTISING AND SALES PROMOTION

ROLE OF ADVERTISING AND SALESMANSHIP

Advertising is the principal method of demand creation, the other important method being the employment of salesmen. The use of salesmen involves personal salesmanship, while advertising is referred to as impersonal salesmanship. Salesmanship is indispensable for demand creation, the object of which is to arouse interest and desire of the buyer for a particular product. Demand creation is a continuous and ever-growing function of marketing with a view to expanding or bolstering the demand for products. In personal salesmanship, expert salesmen are employed to make direct contact with buyers, to convince them about the merit and superiority of product, and finally, to persuade them to buy the product. In advertising or impersonal salesmanship, sales message is conveyed to millions of buyers through printed words or symbols for influencing the consumers' choice of goods in the market. To get the best results of demand creation, both these methods are coordinated and dovetailed in the sales promotional effort. Advertising, being a comparatively cheaper method, is directed to prepare the necessary ground for the activities of salesmen and is oft repeated to aid personal salesmanship. Of the four steps in demand creation—(*a*) drawing attention, (*b*) stimulating interest, (*c*) arousing desire and (*d*) securing action, advertising is effective in the first three steps, while salesmanship goes in for securing action.

From the comparative viewpoint, personal salesmanship is no doubt more effective than advertising in procuring business. But the high expense involved in reaching a limited number of persons by salesmen tends to reduce its wide application in marketing. To economise the use of salesmen, advertising is relied upon to a greater extent. To be sure, salesmen can find out prospective buyers, have direct talks with them, remove their doubts and prejudices, answer their individual questions, give demonstration in the use of products, and finally close the sales. An advertisement may be ignored or it may fail for other reasons to secure action, but salesmen always justify their presence either by booking orders or by ascertaining the reason for refusal to buy.

IMPORTANCE OF ADVERTISING

It is advertising that has enabled the businessman to make continuous mass production for the wide international market. Not only

does it convey sales information to potential buyers far and near, it contains positive force determining the action of buyers as well. It applies a veiled method of persuasion to secure patronage for the product. Advertising has ensured the introduction and acceptance of a new product in the market. In the case of existing products, advertising has paved the way for a steadily rising flow of goods to the market. The relatively insignificant amount with which this marvellous result can be secured has made advertising a boon to the businessman.

Advantages. 1. *Market expansion*—Advertising enables the manufacturer to expand the market for products by creating new markets and retaining existing ones. It carries repeated sales messages to millions of buyers and brings customers from remote or inaccessible areas.

2. *Direct appeal to consumers*—Through advertising, manufacturers can appeal directly to consumers and influence their buying habits. Consequently, buyers and producers are freed from the clutches of middlemen.
3. *Buyers' education in using new products*—It helps to overcome old habits of the consumers and to educate them in the use of new products, or in the new use of existing products.
4. *Removal of seasonal fluctuations*—Seasonal fluctuations in demand are eliminated by advertising. Because of creating a steady demand, it has made continuous production more certain and effective.
5. *Reduction in selling price*—Advertising speeds up sales and production turnover. Through a large volume of business, it lowers both selling and production costs. As a result, advertising in many cases has reduced the selling price of goods.
6. *Price stability*—Manufacturers invariably maintain resale prices of advertised products. Advertisement of resale prices permits to keep prices within reasonable limits ; and buyers are assured of more or less the same price, wherever they may purchase goods.
7. *Quality products*—Advertising is usually made under a particular brand name, otherwise it becomes too expensive for the business. Because of this practice, advertising tends to create confidence in buyers about the quality of advertised products.
8. *Promotion of goodwill*—It acquaints the people with the name of producer and guides them to improve living through better buying. Advertising leads to the establishment of producer's goodwill which results in repeat sales.
9. *Freedom of press*—Advertising helps to maintain the free and independent status of the press. As newspapers are mostly

financed by advertising income, they need not be tied down on financial grounds to any party or group.

10. *Higher standard of living*—Advertising promotes greater consumption, increased production and larger employment. The effect of these improvements is inevitably reflected in lower prices, better quality and greater variety of goods to the consumer. Advertising contributes towards a fuller way of life through happy and contented living.

Criticisms. Although the merits of advertising far outweigh its faults, the criticisms cannot be neglected. The following are the important criticisms of advertising :

i. *Unbalanced advertising*—Advertising is sometimes made in such an excessive and unbalanced manner that it increases the cost of marketing and the price of products rather than reducing prices.
ii. *Combative advertising*—Advertising, instead of creating new demand, is often directed to transfer customers from one producer to another. Combative advertising represents a sheer waste from the social point of view.
iii. *False advertising*—Advertising fails to achieve its objectives and destroys public confidence in those cases where false and exaggerated claims are made about the virtues of products in advertising.
iv. *Deceptive advertising*—Advertising has been misused to defraud buyers by inducing them to purchase goods of doubtful value.
v. *Lack of dignity*—In their zeal for demand creation, advertisers sometimes adopt objectionable practices that are totally devoid of ethical sense, moral value or public decency.
vi. *Propensity to artificial living*—Advertising creates tastes and desires for some products in such a way that many persons are forced to buy things beyond their means, and others are discontented for not being able to buy the product.

Regulation of Advertising. The importance of advertising can be fully realized provided the abuses thereof are stopped. In order to eliminate the defects of advertising, a number of measures have been devised by the businessmen as well as by the Government. The usual measures that are applied may be stated as follows : (*a*) Obscene advertisements are totally banned by statutes, as they offend public moral. (*b*) Noisy advertisements through the use of loud-speakers or beating drums are restricted, since they appear as a public nuisance. (*c*) Writings on the walls or other public places are prohibited by injunction. (*d*) To guard against deceptive advertising, regulatory

laws are enforced by the State. In our country, the Essential Commodities and Drugs Act has been passed for controlling the sale of medicines, food products and some other essential items. But unfortunately, the legislation has lost much of its strength in the absence of administrative vigilance and rigid enforcement. (*e*) The chambers of commerce set up "better business bureaus" to regulate advertising. (*f*) The consumers' associations or their co-operatives raise some voice against unethical advertising.

PROS AND CONS OF ADVERTISING

Of the two principal methods of demand creation, advertising has been made the target of criticism, while personal salesmanship escapes such public censure. Advertising is singled out as a wasteful method of competition. Advertising is believed to be the sole reason for high marketing cost. To be sure, this is an entirely erroneous belief. On the contrary, advertising has reduced the cost of marketing and thereby, it has cheapened the price of products. In the absence of advertising, demand creation is to be effected by the use of personal salesmanship and by the distribution of samples. As the use of personal salesmanship involves too much cost, businessmen have been compelled to take resort to advertising to supplement their sales promotion effort. Further, the market has become so wide today that it is impossible on the part of salesmen to reach every consumer in the market. But a single advertisement can carry the sales message to countless consumers. The necessity of mass selling has become inevitable at the present time to match the production carried out on a mass scale. Requirements of mass selling have made advertising indispensable today than it was in the nineteenth century. Advertising expense is deemed excessive when the total amount spent on advertising is only looked at. But the unit cost of marketing including that of advertising is ignored by the ill-informed persons who condemn advertising outright. Furthermore, the critics fail to see that the amount paid to sales staff on account of salaries and commissions has remained even now higher than advertising expenses in most concerns.

"*It pays to advertise*" claim the proponents of advertising. They point out the benefits of advertising in extending the frontier of sales, in reaping the economies of mass production, in reducing the prices of products, and in improving the quality and variety of available goods. Advertising does the same function in selling as machines do in production. If the use of machines is not objected to on the cost ground, advertising cannot be labelled as a costly method for its use in sales promotion.

The opponents answer it by saying that machines, unlike advertis-

ing, do not adopt the technique of persuasion. It is contended by them that advertising renders a useful service in market informing of new products, new uses of existing products or about quality and price of the available products. On the other hand, opponents point out that the amount spent on false advertising, deceptive advertising as well as on combative advertising must be regarded as a total waste of national resources and they conclude that *"advertising is wasteful"*.

It cannot be denied that there is much truth in both these viewpoints. What is wanted is the retention of benefits of advertising and the elimination of its abuses. Objectionable practices in advertising must be rooted out to secure the maximum result of it. In fine, advertising is the basic tool in the hands of businessmen in a competitive economy which has ensured the steady growth of business. Many products which we use today would have remained confined to the laboratory stage after inventions if businessmen had not developed them by sales efforts, whether promotional or operational.

ADVERTISING MEDIA

The sales message of the advertiser can be conveyed to the public in different ways. The vehicles or means which are used for communication purposes are known as advertising media. Of all the media, printed words carry the greatest amount of advertising. Accordingly, advertising is referred to as the *"task of selling through print"*. Newspapers, journals, magazines, circulars, catalogues, directories, posters and handbills contain written messages for the literate public. Besides, there are radio, television, cinema, electrical signs, placards, bill boards, delivery vans and window-dressing that carry sellers' appeal to the consumers. The selection of a medium is made with reference to a number of factors like the nature of products, composition of buyers in the market, extent and efficiency of appeal or the cost of using each medium. The following are the important media of advertising :

Newspapers—Newspaper advertising is the most common method adopted by almost all advertisers, particularly in the case of products for daily use. Because of their large circulation, advertising can reach millions of persons at an insignificant cost. Newspapers offer many advantages as a medium. Besides widespread appeal, advertising can be directed at the right time and to the right places. The contents of advertising can be adjusted frequently to suit varying requirements of sales effort, seasonal changes or other current developments. Space, position or repetition of advertising can be decided by the advertiser as he likes it. Newspaper advertising is effected in two different ways—demonstrative advertising and classified advertising. Demonstrative advertisement appears in bold letters with illustrations and pictures for

the purpose of drawing greater attention and creating more interest. Classified advertisement is made under appropriate headings in small types.

Magazines and journals—Magazines can be of two types—general magazines and special magazines. General magazines are circulated widely among the reading public, whereas special magazines and technical journals are confined to a selected class of people. Both of them have certain advantages over newspaper advertising. Advertisement is not overlooked, as the magazines and journals are read over a longer period. Because of their good quality of paper and of the facility of colour printing, advertisements can be made very attractive to arouse interest. But they do not offer the timing facility, since the contents of advertisement are to be sent much in advance.

Radio and television—Although these media are not common in our country as yet, they are growing popular in other countries and coming next to newspaper advertising in importance. Sales message is prepared through a programme in such a way that it draws attention, creates interest and stimulates desires. Through the medium of varying wave bands, advertisement can be made for the local or national market. Further, as the radio programmes can be tape recorded, advertising is amenable to repetition at a lesser cost.

Other media—Other media are mostly used as adjuncts to newspaper and magazine advertising. They may be divided into the following three groups : (*a*) *Direct mail advertising* includes letters, cards, calendars, booklets, catalogues, circulars, etc. Some form of direct mail advertising is resorted to by all concerns for conveying sales message to the individual and specific customer rather than to the general public. (*b*) *Outdoor advertising* comprises posters, painted boards in public places and public vehicles, or electrical signs. This form of advertising has the advantage of flexibility as to the choice of locations, frequency of changes, variety of contents and multiplicity of places. Outdoor advertising is made in attractive colour and artistic manner ; hence, it makes a good appeal to the passer-by. (*c*) *Display advertising* through films and window-dressing is an effective device for creating interest and arousing desire. In the case of retail trade, special emphasis is given upon window-dressing which often induces action on the part of buyers.

Selecting the Advertising Media. A number of considerations are involved in choosing the appropriate medium or media in which advertisements will be given. Important considerations include the following :

1. *Nature of products*—Products are required to be analysed to ascertain whether they meet the demand of domestic consumers or industrial users. Consumers' goods are usually advertised in newspapers, general magazines, radios and motion picture "shorts". Producers' goods

on the other hand find publicity in special magazines, technical journals and direct mails.

2. *Extent of the market*—The extent of the market is determined not only by the geographical area but also by the population size and the purchasing power of the people concerned. To carry the sales message to all potential consumers in the market, the medium is to be selected on the basis of facts obtained from market survey and research.

3. *Standard of consumers' education*—From the standpoint of education, consumers in India can be divided into three groups—illiterate, literate and highly educated. As the illiterate persons have no knowledge of the three R's, newspaper advertising, magazine advertising or any other advertising in written words is useless for them. Although literate persons are familiar with the regional language, they are mostly deficient in English. Highly educated persons on the other hand have a preference for English dailies or weeklies. Accordingly, newspaper advertising must be supplemented by several other media for carrying the sales message to all concerned.

4. *Objective of advertising*—The objective of the advertising programme may relate to the introduction of a new product or the demand creation of an existing product. Again, the demand creation may be intended for improving immediate sales or building institutional goodwill, and the advertising medium is bound to vary accordingly. It is evident that the objective of advertising casts a significant influence on the choice of media.

5. *Circulation of media*—Consistent with the nature of products and the extent of market, the circulation of various media is determined with reference to the quantity and quality of readers of the advertisement. In the light of competitors' practice of making advertisement, the selection of media is to be effected in such a manner as to have the widest coverage of potential consumers.

6. *Assistance from the media*—The amount of co-operation and assistance that can be received from a medium becomes a major factor in choosing an advertising medium. Many magazines, newspapers and other advertising media give valuable aid in the form of marketing research, copy writing, mailing lists and other like information. Such assistance becomes very often a deciding factor in selecting a medium.

7. *Cost of media*—The high cost of space in national magazines and leading newspapers calls for an evaluation of alternative media in view of their comparative costs and advantages. The aggregate cost and the cost per enquiry or per sale are required to be analysed for evaluating the effectiveness of advertisement. Although the aggregate cost can be found out easily, the cost per enquiry or per sale cannot be ascertained unless advertisements are keyed and the coupons are used thereto.

Measuring Effects of Advertisement. To assess the results of newspaper and magazine advertising, coupons and key addresses are used in the advertisement. Readers are offered samples, gifts or booklets free of cost in those cases where they make applications to the company through the medium of coupons. When several magazines or newspapers are used, different key addresses are employed to ascertain the effect of each advertisement separately and the advertisement is said to be keyed. Again, for different insertions in one particular publication on different dates, varying symbols or codes are added to the key address so as to appraise their results individually.

ADVERTISING COPY AND ITS MAKE-UP

Advertising copy contains the message of the advertisement. For advertising in newspapers, magazines and other publications, such message is conveyed through reading material in written words and pictures. For radio advertising, the message is communicated through talking material in spoken words ; and for film and television advertising, the message is embodied in both reading and talking material. According to the differing nature of advertising media, the copy of advertising may represent some reading, talking, or combined reading and talking material.

Irrespective of its nature, the advertising copy in all cases is to be drawn up in conformity with certain cardinal principles. *First,* advertising copy being meant for conveying information, it must provide such information through as simple, clear, concise and complete a copy as possible. A simple and clear copy requires the use of known words and familiar phases rather than the introduction of rare words and high-flown phrases. Conciseness or brevity is the art of copy writing and lends much in gaining public reception for a product. A complete copy is what gives full information relating to the source and time of availability of the advertised products or services along with their costs. *Secondly,* the copy should be drawn up with a special objective in view rather than the general one of increasing sales. As sales are circumscribed by a number of barriers like feeling of high prices, existence of rival brands, lack of quality confidence or knowledge of poor performance, the message of the copy should be directed to dispel the wrong impression or to overcome the consumer resistance. *Thirdly,* the copy should be designed with an eye to enlist the support of prospective consumers. A general appeal to all falls into deaf ears and fails to draw the attention of any particular group or section of the community. Accompanied by a proper layout with suitable headings and illustrations, an effective copy carries the message to those people who are likely to use the advertised products or services. *Fourthly,* the message

of the advertisement is of no avail unless it can create consumers' interest in the product. In the absence of faith or confidence in a business and its products, no interest can be expected on the part of consumers. For this purpose, copy must be grounded in a tone of sincerity and believability. The message must be capable of inspiring confidence in prospective consumers and of winning their acceptance. *Finally,* the copy should stimulate a deep-seated human desire through making an appeal to the inner yearnings of the consumer. That is to say, the copy is to be based upon a central theme of appeal.

The make-up or component parts of the copy of advertising can be viewed from two aspects—advertising theme and advertising layout.

Advertising Theme. A theme represents a particular viewpoint or a central idea with which the message is conveyed to consuming public. The theme involves a rational appeal based upon human emotions, desires or sentiments. Such well-thought-out and specific appeals become effective in arousing desire and in initiating action on the part of consumers. The following are the common themes used in advertising :

1. *The theme of beauty*—The sales appeal for cosmetics, perfumeries and toilet products are usually based upon the theme of beauty. Accordingly, the message of the advertisement contains expressions like "For romantic or charming appearance, use product A", "Product B ensures alluring or exquisite complexion", or "Care your hair with product C for glossy glimpse and luxuriant growth."
2. *The theme of pride*—The sales message in the case of jewelleries, radios, costly clothes, motor cars and others is laid upon the theme of pride, since the acquisition of such products is deemed as proud possessions on the part of buyers. For example, "Prestige car means A", "Radio B adds decency to any home", "Discerning people prefer fabric C", or "X's Jewellery adorns fashionable ladies."
3. *The theme of health*—Food products and drugs are advertised through reliance upon the theme of health. To take some examples, "Product A supplies boundless energy and vigour", "Health brings happiness—and the key to health is held by product B", "Product C keeps you free from disease", or "Eminent physicians prescribe C for cold and cough."
4. *The theme of comfort*—Products which aid in giving comfort to people at work or at home are advertised through the theme of comfort. Electrical fans, air-conditioning plants, refrigerators and like others belong to the group of products meant for providing comfort.

5. *The theme of economy*—This is a common appeal used in many cases for making bargain purchase, for saving money or for protecting costly things from decay and destruction.
6. *The theme of fear*—The theme of fear is utilized by insurance companies and safety-vault operators in expanding the demand for their services. Possible dangers and their consequences are presented in the copy of advertising for initiating action on the part of their customers.
7. *The theme of emulation*—The desire for imitation is strongly implanted in human nature. By giving illustrations and factual information as to what some distinguished persons do, the message of the advertisement may call for imitation on the part of others. To take one case, "The successful men all over the globe use Blade A."
8. *The theme of distinction*—The desire for individual recognition, distinct social status and superior community standing is inherent in human beings. As an outward mark of that distinction, selected products of very expensive nature are acquired by a class of people who may be high-borns or aristocrats and the message of the advertisement is conveyed to them.
9. *The theme of affection*—Baby foods, toys and other playthings are advertised on the basis of this theme. By directing appeal towards parental love, the copy of advertising becomes effective in securing action on the part of buyers.
10. *The theme of patriotism*—The appeal for products of national origin is sometimes based upon national sentiments. For the prosperity of a nation and its citizens, the theme of patriotism makes out a case for using national products in preference to goods of foreign origin.

Advertising Layout. Layout is the logical arrangement of components of an advertisement in the copy and deals with systematic presentation of the message. The pattern of layout varies according to the medium to be used. For newspapers and magazines, the presentation of the message is visible in written words and pictures ; in radio the presentation is audible in spoken words and sound effects ; and in television, both audio and visual presentations are practicable. In all cases, balance and symmetry are of prime importance in presenting the message within the allotted space or time.

As a blueprint of the advertisement, visual layout in any publication can be divided into the following three parts :

a. *Headlines*—Headlines are used in bold letters for drawing attention of the consuming public. The size and length of the head-

line must be appropriate to the general format and page size of the publication ; it must also be in keeping with the theme of advertising and with the entire make-up of the copy. Usually, short headlines are given stressing some facts, suggestions, propositions or convictions. In magazines and trade journals, colour printing is adopted for headlines to make them more prominent and conspicuous in character.

b. *Illustrations*—Illustrations are given by way of pictures, symbols or photographs for drawing attention, creating interest as well as for arousing desire. Significant illustrations may be worth a thousand words in securing public reception for the product. But limits of decency must not be exceeded in presenting pictures or photographs which should always be in good taste. Obscene and objectionable pictures do more harm than good to the cause of advertisement.

c. *Texts*—Texts provide the heart of the message of advertisements, and they are to be woven around an advertising theme. For an individual copy, one theme is desirable ; a multiplicity of themes creates confusion and weakens the strength of appeal. For presenting the text, different practices are followed in the business world. In some cases, the text is prefaced by a statement of problem to the reader and followed by a solution thereof. In other cases, reading materials are presented in an analytical manner with pertinent facts and data. Furthermore, the text may be presented by the use of type face in one copy or of hand lettering in another copy.

ADVERTISING CAMPAIGN AND MARKETING RESEARCH

For creating the demand for new products introduced in the market or for bolstering the demand for existing products, advertising is carried out in many cases in the form of campaigns. Advertising campaign refers to the systematic and organized efforts directed over a period towards influencing consumers' choice of products in the market. In advertising campaign, the message of the advertisement is conveyed in different ways and through different media. Consumers are bombarded, so to say, with sales literature of the advertiser requesting their patronage towards the advertised products. Because of their extensive and repeated appeals, advertising campaigns are costly in character. For securing better results with minimum costs, advertising campaigns are invariably planned beforehand. To aid such campaign, factual information relating to market situations and possibilities is supplied by the activities of marketing research.

There are five sequential steps involved in any advertising cam-

paign. *First,* a specific objective of advertising is to be determined at the beginning. *Secondly,* in conformity with the objective, the theme of advertising is to be decided upon. *Thirdly,* the theme is translated into the message of advertisement in the advertising copy. *Fourthly,* layout is to be designed in accordance with the type of medium to be used. *Finally,* the actual medium is selected for conveying message to the people. Copy, layout and medium are, however, mutually dependent and they complement one another.

Marketing Research. Marketing research has nowadays become an important marketing function with many large-sized concerns. Marketing research provides information concerning the area to be served, the buyers to be counted upon, the buying habits and purchasing power of consumers, the number of salesmen to be engaged in each market with definite sales quotas, the product pricing to be adopted, and a myriad of other information. Effective sales management is rather impossible today without the assistance of marketing research. In matters of advertising too, marketing research is of immense help in directing the sales appeal for encouraging and rewarding results.

Marketing research activities fall into three major groups—*research on products or services, research on markets and research on sales methods and policies.* Of the various activities in marketing research, the more prominent activities include the analysis of territorial sales potential, the determination of a product's competitive position and the assessment of the size of the market for a specific product. Important uses of marketing research can be summarised under the following five heads : (*a*) it ascertains the standing of the company in the specific industry, (*b*) it indicates the present and future trends of the industry pertaining to the company's business, (*c*) it aids in the development and introduction of new products, (*d*) it shows the way for improving and innovating the present products of the company and (*e*) it results in appraising and increasing the effectiveness of sales management.

Facts and data are collected in marketing research from both primary and secondary sources. Because of the easy availability of information, the secondary sources are commonly investigated before the exploration of primary sources. Secondary sources of marketing information are composed of libraries, trade publications, Government publications, trade associations, business and agricultural research bureaus, research foundations and like others. Primary sources include reports from salesmen, dealers, competitors and consumers in addition to company records. For gathering information from primary sources, different methods are employed, viz., business trips, informal counts, questionnaires, interviews, telephone calls, direct testing and motivation research.

THE ADVERTISING AGENCY

A few decades back publishers experienced difficulty in selling their spaces, and advertisers found themselves inexperienced in planning and preparing the advertising campaign. As a mediating link between the publisher and the advertiser, the advertising agency came into existence to assure fuller utilization of publishing spaces, on the one hand, and to render specialist services in respect of advertising to the advertiser, on the other. Today advertising agencies have become well established, and the growing importance of them is to be witnessed from the new agencies that are being added to this line of business. Advertising agencies provide a number of services for the benefit of advertisers like planning campaigns, writing the copy of advertising, arranging layout, selecting media and effecting agreements with them, supplying art work, making colour printing and verifying insertions. Functions of advertising agencies can be put under the four heads : (*a*) planning the advertising programme and providing for its co-ordination with other marketing efforts, (*b*) making the actual advertisements, (*c*) placing the advertisements in appropriate media and checking their effectiveness and (*d*) rendering various services by way of conducting test campaigns, preparing sales manuals, suggesting package and label designs, and designing catalogues.

Except some special services like art work and colour printing, no separate compensation over the media cost is claimed by the advertising agency from the advertiser for the services rendered. A commission amounting to fifteen per cent of the media cost has become the common method for compensating the services of advertising agencies. The fifteen per cent commission granted by the publishers off their regular advertisement rates constitutes the remuneration of advertising agencies. Besides the commission basis, compensation for services is also paid on a fee basis in some cases.

A number of advertising agencies have been established in the country during the past decade or so. As a step forward, the Advertising Council of India has been recently formed by advertising agencies, advertisers, publishers and other allied interests in the country. On the recommendation of the Press Commission, the Council has been organized by several constituents like the Indian Society of Advertisers, the Advertising Agencies Association of India, the Indian and Eastern Newspapers Society, the Indian Language Newspapers Association, and the Federation of Master Printers. The aims and objects of the Council are (1) to clean up what remains of unethical and anti-social practices or abuses in the advertising business, (2) to investigate and promote the use of new media suitable for adoption by all classes of advertisers for reaching the public, (3) to promote joint efforts for the education

and training of people in the art of advertising, and (4) to promote individual or joint efforts for basic market survey, study and research so as to further the cause of effective advertising in the country.

SALESMANSHIP

The skill in selling goods is referred to as salesmanship in popular parlance. Such skill is possessed by the salesmen, whether they are engaged in actual selling at the counter of the shop or in promoting sales by way of field work. These two broad classes of salesmen are denoted by various names. The salesmen engaged in actual selling are known as service salesmen, counter salesmen, shop assistants or retail salesmen. On the other hand, salesmen employed for promoting sales are called creative salesmen, field salesmen, or missionary salesmen. Of the two classes, the role of creative salesmen is a challenging and trying one, because it is the task of these salesmen to break new grounds and to cross constant hurdles in the process of creating ever-growing demand for products. By salesmanship, the work of the creative salesmen is usually understood and discussed in the business world.

Importance of Salesmanship. The amount and frequency of sales determine the future of any business. All other activities in a business are subordinate to sales in importance and are fed or supported by sales. Accordingly, to keep the business growing and prospering, sales are to be expanded and inflated every now and then, otherwise the business languishes and goes to ruin. This all-important task of expanding sales falls upon the salesmen who remain busy in demand creation.

The use of salesmen for demand creation is what is meant by personal salesmanship, while advertising goes by the name of impersonal salesmanship. Both these types of salesmanship are employed to complement and give support to each other in their common work of demand creation. Without the assistance of one, the other fails to secure the desired results. As already pointed out, of the four steps in demand creation, viz., drawing attention, creating interest, arousing desire and securing action, advertising is effective in the first three steps and fails in the last step. Personal salesmanship is applied for stepping in the deficiencies of advertising, and thereby the cost of salesmanship, both personal and impersonal, is kept within reasonable bounds. By personal touch and counselling with the consuming public, the salesmen very often succeed in enlisting many people as permanent customers.

The Team of Salesmen. The development of an aggressive and enthusiastic team of salesmen is a prerequisite to sales promotion work. For this purpose, extreme care and absolute justice are necessary in all

personnel matters of selection, training and remuneration. The specialist skill of salesmen consists of a number of attributes like communicative ability, emotional stability, judgment, courage, determination, self-confidence, imagination, technical knowledge of sales work, and so forth. From the elaboration of salesmen's attributes in textbooks on salesmanship, it appears that salesmen should have all the virtues of the business world combined in them without any vice thereof. In actual practice, the list of attributes is taken as a fantasy by the businessmen. What the list of attributes suggests is that sales, being number one basic function in any business, must be staffed by the available best-grade men.

The recruited salesmen are given special training in salesmanship through study courses arranged both within and without the enterprise. Furthermore, salesmen are trained for making effective utilization of *the sales manual* and *the sales portfolio*. The sales manual provides the salesmen with a means of getting ready reference concerning all details of the products. Information like size, colour, strength, specifications, designs and costs of the products, satisfied users, past sales achievements and many others is contained in a handy form. The sales portfolio contains an integrated series of illustrations relating to each product. To make the sales presentation more effective, oral statements of the salesmen are supplemented by visual aids provided through illustration in the sales portfolio. As a result, the sales presentation becomes an audio-visual one rather than mere audio presentation.

As regards compensation, salesmen are usually given some extra-commission on the new business procured by them as well as some travelling allowances over their fixed salaries. Special prizes and rewards are also offered by many companies for motivating the salesmen towards high performances. Performances of salesmen are measured and appraised against the standards set up in the sales budget. Generally speaking, fixed quotas in terms of money values or product units and definite market areas are allocated to each of the salesmen. The number of product units sold, calls attended, demonstrations given, miles travelled, trading centres covered or new accounts opened provide the other important bases of control.

SALES PROMOTION

Sales promotion work is conceived of in two different senses. In a broad sense, sales promotion work includes all those activities which are directed towards promoting or bolstering sales. From this standpoint, sales promotion work encompasses activities like advertising, personal selling, innovations in products, and improvement in marketing methods in addition to some auxiliary efforts to personal and impersonal salesmanship. Narrowly speaking, sales promotion work means such activities

as are necessary for aiding personal selling and advertising. The usual auxiliary efforts to salesmanship may be stated as follows :

Premiums. On the purchase of some specific product, the premium is given to the buyer by way of either supplying a gift article or providing the opportunity to purchase an article at greatly reduced price through coupons, stamps as well as tokens. The premium provides the inducement to purchase products on the part of consumers. According to the mode of offering premiums, the premium scheme falls into two categories—(*a*) premium articles and (*b*) the premium coupons. In the case of premium article, the gift article is enclosed in the package of products in question and is available at the point of purchase. But the success of the premium article is dependent upon the wise selection of both gift articles and the specific product that earns premium. Gift article should be one of good taste and it must be looked upon as a proud possession on the part of buyers because of the non-availability of such articles in the market. As regards the product earning premiums, it must be of small size, of common use as well as of short lasting in character. The premium coupons attract rewards in various ways. Certain minimum number of coupons may be exchanged for some enumerated gifts, for obtaining other products at concessional rates or for cash amounts.

Premiums arm the salesmen to make effective sales presentation, stimulate sale in a particular market area, lead to the enlistment of new customers, and pave the way for introducing new brands in the market.

Samples. For the introduction of new products in the market, samples of such products are distributed to the selected customers. The sampling system is followed from time immemorial in sales promotion work, and even today it is in as much use as it was earlier, particularly in the case of drugs, cosmetics, perfumes and other like products. As the distribution of samples is very costly, this system is confined to those products of small value which have oft-repeated sales. To economise the cost of sampling, sample packets of smaller sizes are made out by many companies. The sampling system is an effective device of sales promotion, because the consumers are provided with an opportunity to examine the product and to see its merits before purchasing such product. Furthermore, as the distribution of samples is resorted to in the case of new products, explanatory literature can be added detailing the mode of use and the features of the product.

Contests. Contests are held for increasing the enthusiasm of salesmen, for securing the support of dealers, and for arousing the interest of consumers. Accordingly, contests fall into three distinct classes, viz.,

salesmen's contests, dealers' contests and consumers' contests. Contests for salesmen and dealers are intended for inducing them to devote greater efforts or for obtaining new sales idea in the task of sales promotion. Prizes are given to the best group of marketers on the basis of their sales performances. Contests for consumers are held on the subject of writing a statement. Such statements centre round the questions as to the likings of a customer for the product, suggestions in respect of new uses for a product, or formulation of new advertising idea for the product.

The success of contests requires the enlistment of a sufficiently large number of participants, competent judging of entries and absolute fairness to all contestants in declaring results. Rewards are given in cash or in merchandise ; in addition, salesmen may be rewarded by promotions and bonuses.

Fairs And Exhibitions. Fairs and exhibitions provide an important means of sales promotion. Fairs and exhibitions are held on a local, regional or international basis. Fairs are annual congregation of buyers and sellers at some centrally situated places which have historical or religious importance. Exhibitions, on the other hand, have no fixed time and place of their organization. Exhibitions provide ample opportunities to the manufacturers, both large and small, for demonstrating the industrial products, explaining their special features and usefulness, and hence, for extending the sales horizon of the business. Industrial exhibitions are organized in many cases on the active support of the State. Like the fairs, the industrial exhibitions are held at the national and international level. Not only sales promotion and buyers' education in the use of products take place in these exhibitions, but significant ideas are also obtained by the industrialists for innovating their products or services to the benefit of all concerned in any business.

Public Relations. Public relations activities have become an important contributory to sales promotion and market standing of an enterprise. Public relations activities strive for maintaining a cordial relationship between the enterprise and the public through influencing or informing customers and other groups of the community. Customer complaints, grievances or prejudices are given adequate attention to win over their support. Briefly, public relations aims at enlisting good attitude and favourable opinion of the general public towards the enterprise. Unlike advertising, immediate and direct demand creation is not the purpose of public relations, although it takes resort to some form of publicity. For example, business enterprises convey their greetings and thanks to the public through newspapers and other published media for enhancing prestige, reputation and goodwill of the business.

CHAPTER 31

CHANNELS OF DISTRIBUTION

TRADE CHANNEL AND ITS SELECTION

The trade channel or the distribution channel is the path or route along which the goods move from the hands of producers into the hands of consumers. To reach the consumers, goods may pass many hands, cross several hurdles and travel long distances. Trade channels are not identical in the case of two different classes of products. Farm products require a different channel from that of manufactured goods. Further, manufactured goods may be either producers' goods or consumers' goods, and accordingly, varying trade channels are adopted for the marketing of these goods. Based on the buying habits of the purchasers, consumers' goods can again be subdivided into three main groups—*convenience goods, shopping goods and specialty goods*. Convenience goods refer to those consumers' goods which the consumer usually desires to purchase with the minimum expenditure of time and effort from a nearby and convenient store. Such goods are purchased in small amounts day after day with little fashion element involved therein. Common examples of convenience goods include groceries, meats, fruits, drugs and stationery articles. Shopping goods imply those goods which are purchased infrequently after comparing their quality, price and style in a number of stores. The purchase of shopping goods often involves a significant expenditure, and unlike the convenience goods, the actual purchase can be deferred for some time. For the marketing of shopping goods particularly, a good amount of sales effort is made nowadays and large-scale retail organizations have come into existence for the purpose. Wearing apparels, shoes, rugs, piece goods, musical instruments, jewellery and other fancy goods are prominent examples of shopping goods. Specialty goods are those which have a special attraction for the consumers and accordingly, they make a special purchasing effort for acquiring such goods from a distant place. Specialty goods are high-priced products which make their sales appeal on quality considerations with a specific brand name. High-grade clothing, expensive perfumes, watches, radios and electric fans are common examples of specialty goods.

Although there are numerous channels of distribution, they can be broadly put under the following five types :

1. Sale by the manufacturer direct to the household consumer or industrial user.

2. Sale by the manufacturer to the retailer who sells to the consumer.
3. Sale to the wholesaler who sells to the industrial user.
4. Sale to the wholesaler who sells to the retailer for resale to the consumer.
5. Sale to an agent middleman who sells to wholesalers or large-scale retailers for resale to small retailers and consumers.

Considerations in Selecting Channels. In selecting channels or outlets of distribution, the decisions are necessary not only on the *type of outlets* to be utilized, but also on the *number of outlets* to be used. Important considerations in choosing outlets of distribution may be stated as follows :

1. *Nature and use of products*—Products are analysed to ascertain whether they belong to the category of consumers' goods or producers' goods. Classification of consumers' goods into convenience, shopping and specialty ones generally dictates the type and number of outlets to be employed in a specific situation. In the case of producers' goods, although heavy machinery and equipments are sold directly to the industrial user, the tools and operating supplies are marketed through agent middlemen. So far as the use of products is concerned, the selection of channels is influenced in a number of ways. The greater the variety of uses of a product and the more frequent the number of its purchases, the wider would be the channels of distribution. For fashion items and perishable products, the channel is shortened to ensure rapid distribution of products. Products requiring after-sales service are distributed through properly trained middlemen or through the manufacturers' sales depots. Seasonal products and low-priced products are marketed through wholesalers for avoiding the cost of storage and other marketing functions.

2. *Nature and extent of the market*—The study of the market gives an idea of the number, location and buying habits of potential buyers and users. To ensure adequate distribution of products throughout the market area, the manufacturer should adopt such channels as would make it possible for buyers to secure the product without difficulty. In general, the greater the extent of market for products, the more widespread would be nature of their distribution.

3. *Review of existing channels*—A fixed pattern of distribution is found to exist in the sphere of marketing different products. As consumers become accustomed to buying goods from the established channels, the manufacturers have to adopt the existing channels used by competitors. But the recent trend towards *scramble merchandising* has complicated the marketing problem, and it has become a common sight nowadays to find the drug store handling stationery-store items and *vice versa*. Accordingly, the wise selection of distribution channels calls for a familiarity with current developments in marketing and their impact on the traditional channels.

4. *Effectiveness of alternative channels*—In the light of sales

volume and selling costs involved in each channel, the profitability of various channels provides the basis for making necessary selection. The effectiveness of alternative channels cannot be appraised objectively unless the same amount of care is devoted to formulating and executing the sales programme in each case.

5. *Mutual co-operation and assistance*—The degree of co-operation received by the manufacturer from dealers by way of securing promotional assistance, financial assistance or after-sales service influences the choice of a channel and enhances its effectiveness. Depending not only upon the dealers' assistance to manufacturers but also upon the forms of assistance that can be extended by the manufacturer to dealers, one channel becomes more appropriate than others. Manufacturers usually extend advertising and sales promotion aid and the service of missionary salesmen in the case of consumers' goods and furnish assistance by way of making arrangements for training, guiding and instructing distributors in the case of producers' goods.

6. *Distribution policies.*—Distribution policies dictate the number of outlets that should be adopted for marketing a product. Three main kinds of distribution policies are *intensive distribution, selective distribution and exclusive distribution*. Intensive distribution calls for utilizing as many outlets as possible in selling goods to potential customers and it is particularly used in the case of convenience goods. Selective distribution is concerned with choosing between outlets so as to take away the cream of business pertaining to any kind of products. Exclusive distribution or exclusive agency is an extreme form of selective distribution in which goods are distributed in a particular area through one outlet or agency.

CLASSES OF MIDDLEMEN

The businessmen who interpose between the producer and the consumer are referred to as middlemen. The middlemen fall into two classes : *merchants and mercantile agents*. Merchants are the actual traders or dealers who purchase at their own risks with the object of selling the goods at a profit. They must take title to the goods in all cases, although the physical possession of goods may not accompany everywhere. Merchants include wholesalers and retailers. In contrast to merchants, mercantile agents handle the goods not in the capacity of owners, but they render some service in the movement of goods either for buyers or for sellers. Mercantile agents take their remuneration in the form of brokerage or commission and not in the shape of profits like the merchants.

Mercantile Agents. They may be divided into the following three groups :

Commission agents—They are appointed to sell goods on the sole risk and account of the seller. They take possession of the goods, make necessary warehousing arrangements, pass title to the buyers and get remuneration at a certain percentage of commission on sales. When they are authorised to sell on credit and assume the risk of collecting book-debts, the commission agents are spoken of as *"Del Credere Agents"*. To facilitate sales, commission agents usually undertake other accessory functions like sorting, grading, packaging or sampling. Commission agents with enlarged authorities and liabilities over the consigned goods are referred to as *"Factors"*. Factors and del credere agents are also known as commission merchants.

Brokers—Brokers are agents who negotiate sale or purchase of goods on behalf of other parties. Brokers assume neither title to the goods nor possession of them and they are paid a brokerage of certain per cent on the value of their transactions. According to the capacity in which they work, brokers may be selling agents, buying agents, or mill agents.

Auctioneers—Auctioneers are engaged to sell goods under the auction method of sales. Like commission agents, the auctioneers take possession of the goods, display them to the public, sell to the highest bidder and transfer ownership of the goods to the buyer. For the purpose of creating buyers' interest in the goods, various sales efforts are made and several accessory functions are discharged. The goods are usually passed to the highest bidder, subject to any minimum price fixed by the seller. Auctioneers take their commission on the sale proceeds of goods.

Wholesalers. The wholesalers take their place in the marketing channel between the producer and the retailer. They purchase goods in bulk quantities from manufacturers or producers for the purpose of selling them to retailers in small lots. Wholesalers are mainly concerned with assembling and dispersing functions of marketing. They collect goods from different centres of production at a central point and distribute the goods among retailers who remain scattered throughout the market. Productwise specialization is the characteristic feature of wholesaling. Wholesalers generally confine their activities to one product or to a narrow range of products, but they keep different varieties and grades of those products. Other functions of marketing like grading, storing, transporting, financing, etc., are usually performed by the wholesaler. Wholesalers render the greatest service to retailers who are supported and accommodated by them with the supply of requisite quality and quantity of products as well as with the grant of necessary credit. As against this service to retailers, their service to

manufacturers is of secondary importance. The wholesalers' services may be stated under the following two heads :

Services to retailers—(*i*) The retailer is required to carry a large variety of products in small quantities. Accordingly, it becomes impracticable on the part of the retailer to collect these innumerable items of products from widely scattered sources of production. The wholesaler specializes in the collection of goods for retailers who can obtain their entire supplies promptly and economically from a limited number of wholesalers. (*ii*) The distribution of goods in small quantities and in the desired form is another service which is rendered by the wholesaler to retailers. Most of the large producers cannot entertain these small orders from countless retailers on the ground of high marketing costs and resulting inconveniences. Being free from the work of producing goods, the wholesaler takes the trouble of dividing the goods into small lots, for which he is paid a large quantity discount by manufacturers. (*iii*) Trade credit which the retailer requires can only be extended by wholesalers, not by manufacturers. Most of the retail traders pay for the goods after their sale to ultimate consumers. But manufacturers extend credit to wholesalers for the reason that such credit can be supported by bank credit as and when it becomes necessary. (*iv*) Because of the dearth of capital and lack of storage space, retailers become perpetually dependent upon wholesalers for getting steady supply of goods in driblets. It is the wholesaler who creates reserve stocks upon which retailers can obtain their requirement day in and day out. (*v*) The risk of falling prices, of changing demand or of spoilage involved in goods is shifted to the wholesaler who carries large stocks for a longer period. Wholesalers relieve the retailer of the functions of storing, financing and risk-assuming in marketing to a great extent. (*vi*) The wholesaler occupies a strategic and pivotal position in the marketing channel, since he is connected with several manufacturers, on the one hand, and hundreds of retailers, on the other. Having the facility of better information as to the market conditions, he often advises and guides the retailers in their buying activities.

Services to manufacturers—(*a*) Mass production brings in its trail the problem of mass selling. There is no gainsaying the fact that production could not have reached that scale which we find at the present age without the parallel development of mass-selling techniques. The mass sale of goods can only be made to wholesalers who provide the manufacturer with a ready-made sales organization. The method of wholesaling has enabled the manufacturer to reach the market widely and deeply at an insignificant expenditure of time and money. (*b*) Manufacturer is relieved of the anxiety of selling his goods, and as such he can concentrate on production. As soon as the goods come out of the factory, they are usually despatched to different wholesalers.

Because of this process of selling, manufacturer's capital need not be tied up in holding unnecessary stocks, and the uncertainty of market is removed to a great extent. (*c*) Unlike the manufacturer, wholesalers handle many products in their two-way traffic required for both assembling and dispersing. Consequently, the wholesalers can effect several economies in transport cost and storage cost. Moreover, wholesalers share some marketing risks with the manufacturer. (*d*) The benefits of market study and marketing research are reaped by manufacturers through the activities of different wholesalers. Wholesalers pass back the information they secure from retailers so as to keep the manufacturer abreast of style, fashion or demand changes.

Retailers. The business of buying and selling goods begins and ends with retailing. It is the final stage in marketing where the goods are transferred from the hands of businessmen, whether manufacturers or traders, to the ultimate consumer. It is the retail selling which keeps the manufacturers and wholesalers busy in their work of producing or supplying goods. In one sense, all business activities originate in buying activities of consumers. Retailers specialize in this all-important task of selling to consumers. It is beyond the capacity of manufacturers to render that amount of service which the consumer derives from retailers. To meet the consumers' demand and satisfaction retailers carry many lines of goods that come from hundreds of producers and several wholesalers. By establishing shops at convenient places, the retailers look to the ease with which consumers can get their supplies promptly at reasonable prices. Further, retailers extend in some cases credit or delivery services to their customers and give individual attention in matters of supplying the required quantity and desired quality of goods. In short, service is the keynote of all kinds of retailing.

ELIMINATION OF MIDDLEMEN

The middlemen who interpose between the producer and the consumer are looked upon by some as parasites of the society. They are held to be responsible for the high cost of marketing, and hence, for the increased price of products. It is assumed that the merchant middleman and the mercantile agent do not render any corresponding services for their operations towards profit making. Consequently, it is believed that the cost of marketing and the price of products would come down with the elimination of these middlemen.

This erroneous belief arises from confounding the marketing functions with their functionaries. Marketing functions are essential and are to be discharged by some agency best fitted for them. With the

elimination of middleman, manufacturers will be required to undertake these functions. Manufacturing operations cannot be combined with retailing, since the consumers' orders are so small and scattered that they cannot be executed by manufacturers successfully. Wholesale trading can be adopted to some extent by manufacturers or retailers. This process of elimination is to be witnessed in the setting up of large-scale retail organizations like departmental stores, discount houses or multiple shops, as well as in the establishment of manufacturers' sales depots and consumers' co-operative stores. In spite of these steps, wholesalers have not been eliminated, and perhaps they cannot be eliminated under the present system of marketing because of their useful services.

There might be some scope for combining one or two operations performed by different middlemen, but middlemen as a class cannot be eliminated from the complex system of marketing. If the service of retailers is acknowledged, the wholesalers too become necessary to support the retailers with credit accommodation and to feed them with a regular and steady supply of merchandise. To be sure benefits of specialization and of division of labour apply not only in physical production, but in marketing also to an equal extent. The existence of so many middlemen in the market can be explained by the need for specialization. Experience shows that the marketing cost does not come down with the elimination of middlemen ; on the contrary, the cost is likely to go up. In a competitive economy, no businessman can stay in business for a long period without rendering some services to the community. That the middlemen have not been eliminated as yet from the marketing organization is the greatest proof of their valuable services.

TYPES OF RETAIL ORGANIZATION

According to the size of trading organization, retailing falls into two groups—small-scale retailing and large-scale retailing. Small-scale retailing comprises (*a*) independent unit stores, (*b*) itinerant traders and (*c*) automatic vending. Large-scale retailing is carried on by (1) Multiple Shops, (2) Departmental Stores, (3) Discount Houses, (4) Mail Order Houses and (5) Supermarket.

Unit Stores. Unit stores occupy the topmost position in retail trading on the basis of numerical strength and the aggregate value of business. These stores are usually established on a proprietary basis by individuals who fully assume the task of active management. The owner-manager generally confines his activities to one store, although in some cases two or three stores may be set up by him. Establishment of these branch stores does not change the character of such organiza-

tion from unit stores to the chain store ; but basically it remains the unit store, as different shops are managed separately with distinct accounting records. Unit stores are invariably situated at convenient places to cater to the needs of a local community. These unit stores may be either *general stores* dealing in a variety of products or *single-line stores* confining their activities to one kind of products. General stores are more popular in rural areas, while *single-line stores* like the drug store, the cloth store, the grocery store and others appear in greater numbers in urban areas. In addition, the unit stores may take the character of *specialty stores* wherein further specialization is introduced. Specialty stores deal in merchandise of one category, not of the entire line of a class of products, e.g. stores handling hosiery only or infants' wear only.

Advantages and disadvantages—As the unit store is mostly set up by individual proprietors, it carries all the advantages which usually go with proprietary concerns. Facility of formation, simplicity of operation, intensity of sales effort and austerity in management are the prominent advantages of unit stores. The power of perfect adaptability with all changing phases of the business and the scope of personal touch with customers and employees have enabled the unit stores to hold their position in the market. Limited capital and poor managerial ability are the two great disadvantages which arrest the growth of such business beyond a certain stage. All other difficulties stem from these two disadvantages.

MULTIPLE SHOPS (OR CHAIN STORES)

Multiple shops consist of a chain of stores throughout the State or country organized by a central agency for selling the same product. As multiple shops are owned and managed by a central organization, the uniformity of operations is the basic feature of this form of retailing. This uniformity of operations is reflected even outwardly by making the appearance and design of all shops identical in character. Centralized buying with decentralized selling is the basic guide to operations of all multiple shops. The shop manager is directed to sell the goods at fixed prices, and all other functions of marketing like assembling, transporting, advertising, financing, etc. are performed by the central office. To ensure this centralized control, all personnel problems are handled by the central organization.

Multiple shops are organized by manufacturers or wholesalers under the company form which facilitates the retention of central control over all shops. Multiple shops make for a vertical integration of marketing activities, since retail trading is combined with manufacturing or wholesaling operations. All products are not capable of being dealt in under

this system of retailing. Requisite conditions for the successful operation of multiple shops are : (*a*) standardized product, (*b*) quick turnover, (*c*) domestic consumption goods, (*d*) sales on cash basis, (*e*) absence of house delivery or other personal services and (*f*) convenient locations. Because of these conditions, the multiple shops are mostly concentrated in cities and large towns, and they are virtually absent in rural areas. The Bata Shoe Store is the classic example of multiple shops in our country.

Advantages. 1. *Price appeal*—Because of large-scale merchandising and of combination of retailing with manufacturing or wholesaling functions, the unit cost of marketing is reduced greatly in the case of multiple shops. Improved methods of retailing with lower operating costs, high turnover at smaller profit margins, centralized storing arrangement, and elimination of credit and delivery services bring about a significant reduction in cost. Hence, products can be offered for sale at a comparatively lower price.

2. *Quality products*—Since some common and standardized products are sold through all shops, and since the central office keeps a vigilant watch on the handling of products in each shop, the consumers are assured about the quality of products. Buying and assembling, on the one hand, and selling, on the other, are performed in the most effective manner for maintaining quality of products. An expert buying staff makes a collective purchase for all the shops, when these shops are organized by wholesalers. Manufacturers operating multiple shops disperse their own standardized products to different shops.

3. *Attractive and well-located shops*—Favourable situation near the public thoroughfare and attractive layout of stores do not go in vain to arouse interest and to secure action on the part of customers. Several stores in the chain can pool their knowledge, information and experiences to build a cadre of sound sales staff. High-priced sales executives at the central office remain busy in devising means of effective window-dressing on the part of all shops.

4. *Centralized advertising*—One advertising copy dispenses with the necessity of individual advertising expenditures by each store. Because of this common advertising, consumers can be urged to buy through convincing sales messages from all directions. Moreover, self-advertising is done to the benefit of all by each decorated shop which operates as a replica of other stores.

5. *Marketing strategy and research*—The risk of falling demand in one locality can be avoided through the operation of stores in other areas. Further, varying prices can be charged by different shops in different localities to meet competition or to tap the market deeply. Because of direct contacts with numerous consumers through a chain

of shops, the consumers' taste, fashion and buying habits can be closely studied for improving sales on the basis of facts and information collected.

Limitations. 1. *Lack of service and attention*—The shop managers and salesmen are required to sell standardized products at fixed prices, as directed by the central office. Consequently, they may lose all initiative and interest in the work and may not give the desired attention or service to customers. Lack of employers' personal touch with customers and employees may result in customers' dissatisfaction and poor management.

2. *Inflexibility in operation*—As the activities are carried on in a standardized way under the direction of the central office, adaptability to local conditions may not be possible on the part of the individual store. Accordingly, the needs of customers may be ignored by the shop manager.

3. *Danger of rising cost*—The centralized control of a large-scale organization may give rise to many forms of inefficiency, waste, and even dishonesty in branch stores. The requirement of too much reporting to the central office keeps the store manager busy in paper work rather than in actual sales.

4. *Absence of diversification*—As the same standardized products are offered for sale in multiple shops, many customers are forced to step into other stores for the sake of new variety of products. Sale of the same standardized and fixed products from multiple shops appears unattractive to many persons.

DEPARTMENTAL STORES (OR DEPARTMENT STORES)

The departmental store is an integrated retail organization which offers to its customers a variety of products classified into well-defined departments under one roof. It amounts to the clustering of several unit stores around a common selling centre as one co-ordinated whole. It is essentially an urban institution designed for mass selling at the heart of a thickly populated area. It combines retailing with wholesaling functions, and in some cases, with manufacturing functions as well. The departmental store is based on four principles : *large-scale retailing, complete shopping centre, orderly arrangement of products under separate departments and service to customers.*

The departmental store is usually formed as a company, the control of which is placed in the hands of directors. Operative management is carried on by the Managing Director assisted by one general manager and several departmental managers. Each department is operated as an independent store by the departmental manager who is expected to

arrange for buying and selling of goods, to maintain separate accounts, to bear proportionate overhead expenses, and finally to show profit on that part of his department. Some services of common nature like storing, advertising, delivery and collection of credit are performed centrally for all the departments. The total activities are classified under four major divisions for the smooth operation of departmental stores. (*a*) The merchandising division is entrusted with the sale and purchase of goods. (*b*) The sales promotion division is assigned the tasks of advertising, window and store display, and clearance-sale. (*c*) The stores division is responsible for receiving goods and making deliveries. (*d*) Another division takes charge of financial and personnel matters.

Advantages. 1. *Shopping facility*—The departmental store offers the greatest facility to customers for completing their purchases under one roof. Grand display of goods and agreeable surroundings help the customer to make satisfactory choice of goods.

2. *Unique service*—Services offered by these stores can never be expected elsewhere. In order to attract and retain their customers, the departmental stores render a number of services for customers' satisfaction. Free delivery, grant of credit, sale on approval, cash on delivery sales, and execution of telephone orders are the usual customers' service rendered by it. Besides, there exist rest rooms, reading rooms, restaurants, saloons, fashion information centres and the like of them to cater to the needs of customers.

3. *Customers' attraction*—The central situation, neat arrangement, artistic design, fashion leadership and polite treatment make a profound psychological impression upon the customers. Discerning persons with taste derive an aesthetic pleasure that cannot be measured in terms of money.

4. *Large-scale dealing*—Benefits of large-scale merchandising are available to these stores. Goods are purchased direct from manufacturers at a quantity discount for retailing purposes. Elimination of wholesaler permits them to secure quality goods at lower prices for selling on a mass scale.

5. *Expert staff*—The financial strength of departmental stores enables them to engage several experts for the purpose of outbidding competitors by way of pushing sales through fashion leadership and attractive display.

Limitations. 1. *Lack of personal contact*—The owners of the organization lose all personal contact with their buyers. Sales are made by the salaried staff who may not be interested in securing customers' satisfaction.

2. *High overhead expenses*—The elaborate services provided by these stores go to increase the unit cost of maketing. If sales volume is not sufficiently large, this excessive cost may make the price of goods prohibitive. In spite of the services being abused by customers, the stores cannot withdraw these facilities once they are introduced.

3. *Unfavourable location*—The central site of the store becomes costly to the organization and distant to the buyers. Particularly for the purchase of convenience goods, the customers do not like to take the trouble of going to a distantly placed departmental store.

4. *Stock-clearance sale*—To keep abreast with the latest fashion and to maintain its reputation as a seller of quality goods, the departmental store has to arrange for clearance sale from time to time at greatly reduced prices. Consequently, the losses incurred through clearance sales are recouped by way of charging high prices for products.

5. *Maintenance of losing departments*—The bulk of sales income is contributed by a few departments in the departmental store and other departments make little contribution. Despite low sales volume, the departmental store cannot abolish the losing departments for the fear of offending customers and damaging its goodwill.

Departmental Store vs. Multiple Shop. Although departmental stores and multiple shops are forms of large-scale retailing in consumers' goods, they can be differentiated from each other in respect of the following eight points :

1. *Operating methods*—The operations of departmental stores are based on centralized selling with decentralized buying of products, while multiple shops undertake decentralized selling with centralized buying of products or of raw materials.

2. *Number of product lines*—The departmental store deals in various product lines with a number of items in each line. In contrast, the multiple shop confines its trading to one or two product lines with a limited number of items therein.

3. *Nature of goods*—The departmental store gives emphasis on those shopping goods and specialty goods which involve luxuries. On the other hand, the multiple shop relies on such shopping goods as are mostly necessaries.

4. *Location*—Although both of them are urban institutions, yet the departmental store is usually concentrated at the heart of large cities and the multiple shops are found to exist in any thickly populated area of all towns and cities.

5. *Pricing practice*—The departmental store adopts the policy of selective selling to a limited number of customers at high prices. On the

contrary, the multiple shop depends on mass selling of standardized products at comparatively lower prices.

6. *Type of customers*—The departmental store attracts customers from the high-income section of the population, whereas multiple shops find customers from all sections.

7. *Customer services*—In addition to selling goods, the departmental store arranges a number of personal services for customers' satisfaction. The multiple shop, on the other hand, refrains from rendering such services to customers.

8. *Extent of integration*—The wholesaling function is combined with retailing in the case of departmental stores. But the extent of integration in multiple shops may become very wide by the inclusion of manufacturing with all stages in marketing.

DISCOUNT HOUSES

A new form of large-scale retailing that has been developed in America since the World War II is what is known as *discount houses or off-list houses.* The discount house sells products of well-known brands at less than the list price by way of economising operational expenses in a number of directions. The advent of discount houses has seriously affected the operation of wholesale distributors and departmental stores, and many manufacturers and middlemen have been forced to re-examine their traditional marketing policies.

Three factors which have contributed to the growth of this new retail establishment may be stated as follows : (*a*) the resale price maintenance on the part of manufacturer by adding 33 to 40 per cent margins to the cost of production was limiting retailers' sale to consumers ; (*b*) many retailers were convinced that personal salesmanship and customer services became unnecessary in the case of those products whose brands were well established in the market through national advertising; and (*c*) in spite of lower unit prices, the retailers were assured of greater total profits through expanding sales and lower operating costs.

The discount house has reduced its operating cost along three lines. *First,* its trading being confined to merchandise of well-known brands, the cost of advertising and personal salesmanship can be dispensed with. *Secondly,* because of its reliance on reduced price appeal, the discount house utilizes low-rent buildings at outlying areas with inexpensive fixtures and smaller number of shop assistants. *Thirdly,* like other large-scale retailers the discount house secures quantity discount for the bulk purchase of products direct from manufacturers.

Potentiality of the Discount House in India. The popularity of

the discount house in the U.S.A. is accounted for its low price appeal. While the discount house has been accepted as a desirable form of retailing in such a prosperous country, it will become a hundred times more desirable and coveted form of retailing in a poor country like India. There are three special reasons which call for its introduction in India as early as possible. *First,* the marketing channels of consumers' goods are inadequate and uneven in character in India. As a result, interruption in the supply of well-known brands of merchandise has become a regular feature of the Indian market. *Secondly,* the hoarding of products and the cornering of the market by an anti-social group of middlemen have created such a menancing situation as it demands speedy termination by establishing this large-scale retail establishment in great numbers. *Thirdly,* the recent experiment in setting up large-scale consumers' co-operative stores throughout the country for ensuring equitable distribution of essential goods is bound to fail for a number of reasons. The discount house is far more potential than consumers' co-operative for curing the present day ills in our marketing system.

MAIL-ORDER HOUSES

Mail-order business is a distinct form of retailing where the transactions are made through communication by post. Without any personal contact between the buyer and the seller, deliveries are also made through mail service, whether postal or failway. A descriptive and illustrated catalogue containing a graphic picture of goods is the principal medium of sale. The catalogue is revised and supplemented from time to time to make it up-to-date.

Goods are numbered and priced in the catalogue and a minimum value is usually mentioned below which orders are not executed. Goods may be despatched by value payable parcel post, by registered parcel post or by railway parcels. In advanced countries, this form of retailing is steadily being replaced by unit stores and multiple shops. Mail-order business is not practised in our country on a wide scale except in the case of selling drugs and books, and it cannot be adopted in future unless the standards of business ethics improve satisfactorily. The Sears, Roebuck and Company of the U.S.A., the most successful mail-order business, had to convince its customers by the sales policy to the effect that "satisfaction guaranteed or money cheerfully refunded".

Evaluation—It secures the lowest marketing cost, as no shop, salesmen, display and other shop paraphernalia are required in this retailing. Demand creation is made through advertising campaigns, and goods are stored in a cheap warehouse. Transportation cost is sometimes curtailed by sending the goods direct from the factory. Absence of

quality inspection is the stumbling-block to this form of retailing. Delays in delivery and uncertainty as to the quality of goods make the customers hesitant in buying. Bulky and heavy goods are not capable of being dealt in under this form.

OTHER TYPES OF RETAILING

Supermarkets. A new form of retailing that has developed in America during the inter-war period is what is known as the supermarket. This is a large-sized retail institution dealing in food products like the groceries, vegetables, fruits, meats and bakery or dairy produce. Each product is grouped into well-defined departments under one roof for the purpose of selling such goods at low prices without any salesmen. The operation of supermarkets is based on certain principles : (*a*) expansion of sales volume by offering the lowest price, (*b*) assortment and display of several varieties of each product in separate divisions, (*c*) selection and self-collection of products by consumers and conveyance of such products outside the store by trolley, and (*d*) price calculation and payment thereof at checking counters established at several exits of the store. The obvious advantages are large turnover, high profits and low prices. Supermarkets are situated in the outskirts of cities since they require large area at a low cost. Hence, distant location of the supermarket appears to be a disadvantage.

Vending Machines. In advanced countries, standardized products of small size are increasingly being sold in packaged form automatically by selling machines. With the tendering of requisite coins in the slot, products come out of the machine. These automatic machines can be placed indoors or outdoors, and one man can feed as many as 600 machines.

Direct Selling by Manufacturers. Direct selling is resorted to by manufacturers for some compelling reasons. *First*, in the case of those machines, tools or equipments which require special demonstration and after-sales service, manufacturers undertake selling direct to consumers. *Secondly*, direct selling is adopted when the manufacturers are dissatisfied with the available channel of distribution. *Thirdly*, direct selling is relied upon in those cases where the manufacturers feel that they can cater to the needs of customers in a better way through advertising campaigns and intensive sales promotion work. Direct selling is effected by way of opening sales depots in different areas of the market or arranging delivery service for orders secured by the efforts of travelling salesmen. However, this type of retailing is costly ; and as a rule, it remains confined to some selected cases.

CHAPTER 32

FOREIGN TRADE

DIFFICULTIES OF FOREIGN TRADE

Trade beyond national boundaries is associated with several difficulties and complications. Each nation has its own banking and currency system, and the payment for the goods is to be made in the form of exporting country's money through the conversion of importing countries' currencies. Foreign trade is subject to strict customs regulations in respect of tariff as well as of quantity or kind of goods that can be shipped. Trade connection between the buyer and the seller is itself a difficult task, since transactions are made with unknown persons in distant lands through the medium of correspondence and communication. The quality of the goods cannot be inspected by the buyer beforehand. The seller has to ascertain credit-worthiness of the buyer, to arrange for safe delivery of the goods against perils of the sea and to observe customs formalities. Necessity of preparing several shipping documents adds to the trouble of sellers in making transactions with foreigners. In addition to the conclusion of trade agreements and the imposition of customs duty, the two factors which limit foreign trade are exchange control and licence restriction.

Exchange Control. Almost all countries adopt some form of direct exchange control over foreign currencies in order to protect the external value of home currencies and to eliminate the adverse balance of international payments. Exchange control is usually exercised by the country's Central Bank which allocates the available supply of foreign currencies to different importers. As the supply of a foreign currency mainly comes from the export trade, the Central Bank assumes control over export-trade earnings. In this way, both the demand for and supply of foreign currencies are placed under regulation. The degree of control varies with the relative scarcity or availability of required currencies. To meet the acute dollar shortage in our country, all dollars earned by the country's export to the U.S.A. are pooled together by the Reserve Bank so as to utilize them in the best possible way. Various devices are adopted by unscrupulous merchants to evade these exchange regulations. One common device that is adopted to make separate and individual dollar earnings is the practice of over-invoicing of imports or under-invoicing of exports.

Under the control of the Reserve Bank of India, foreign currencies

are dealt in by commercial banks and exchange banks. Although there is no specific market place where these currencies are dealt in, yet the foreign-exchange market is highly organized and international in character. Like the dealing on the stock or commodity exchange, any deviation from the normal price is corrected by arbitrage operations. Normal price is composed of a group of rates for each currency depending upon various factors like interest charges and service facilities. As regards interest charges for the involved time, there are sight rates and several long rates. From the standpoint of service, there may be cable transfer or mail transfer rates.

Import Quotas and Licence Restrictions. The quantity of each class of products that can be imported by a country during a fixed period is generally regulated by the quota system. The Government prescribes the maximum volume for each kind of products that the country may import from foreign lands. In our country, the Central Government announces its import policy specifying quantitative limits of goods at an interval of every twelve months at the present time. Subject to an overall quota fixed for foreign goods, import licences are issued to different merchants permitting them to import a stated quantity of some merchandise. Licences are freely issued in respect of those goods which are of greater use for the country. Luxury goods or goods which are available locally are prevented from entering the country through restricting their licences. With this end in view, goods have been placed in our country under two categories, namely, open general licence (O.G.L.) and restricted licence. Goods falling under O.G.L. are of limited values and of specified categories. Such goods can be imported without obtaining a licence therefor and include items like free gifts of books, sample of products, or perishable products from Pakistan. Goods not covered by the O.G.L. are to be imported under licences issued by the Chief Controller of Imports and Exports or by the regional licensing authorities under his control, as required by the Imports and Exports (Control) Act of 1947. For issuing licences, the importers have been divided into four groups, viz. established importers, actual users, newcomers and other importers. Only after the issue of licences, the Reserve Bank of India grants necessary foreign exchange to the importer.

METHODS OF SECURING FOREIGN TRADE

Foreign trade may be secured by the merchant directly or through an intermediary. Large-sized concerns find direct trading more advantageous to them by the establishment of separate import or export departments. But small traders have to depend upon an intermediary to

handle their import and export trade. There are export houses which may act as buying agents for foreign buyers or as selling agents for local producers on a commission basis. Intermediaries may also deal on their own accounts through an outright purchase in the exporting country and sales in the importing country and take the name of export merchants. Similarly there are import firms or indent houses which specialize in importing foreign goods for others.

Trading through commission houses and other intermediaries has several advantages. Manufacturers or merchants are relieved of the troubles and complications of foreign trade. Exporters are only required to supply catalogues and description of goods to commission houses, while importers are to place an indent or order specifying details of goods with them. All other phases of foreign trade, viz., correspondence and communication, forwarding, financing, insuring and customs details are managed by intermediaries. They also assume credit risk and risk of fluctuation in exchange rates. But selling through intermediaries becomes costly to the parties and reduces their profit margins. Moreover, buyers and sellers do not establish any direct link so that the parties can make further transactions in future.

To avoid these two disadvantages, manufacturers have been compelled to undertake import and export business in their own hands. Sales promotion activities are intensively carried on in foreign lands to bolster up sales. With a wider dissemination of trade news and business information at the present time, direct trading between the foreign buyer and seller is gaining ground day by day. Some of the large manufacturers have moved a step further by establishing foreign branches or agencies for the purpose of developing profitable trade between countries.

PRICE QUOTATIONS AND USE OF CODES

In addition to the cost of goods, there are several charges and expenses which are to be incurred in the shipment of goods to a foreign land. All these charges and expenses are not met by the exporter of goods alone, but some of the expenses may be paid by the importer as well. Accordingly, parties decide among themselves who will bear the charges through different price quotations. The following are the important price quotations in international trade :

Loco price—It covers the cost of goods plus some profit to the seller. The buyer is expected to bear all expenses for lifting and transporting goods from the factory or warehouse of the seller. It is also known as ex-factory price.

F.O.R. (Free on rail)—It means the loco price together with the cost of carrying goods to a railway station and of loading the goods into wagons.

F.A.S. (Free alongside ship)—It includes all costs and charges for bringing the goods to the side of the ship which remains ready for a sea voyage. As goods are procured in many cases from interior parts of the country, F.A.S. price amounts to F.O.R. price plus railway freight.

F.O.B. (Free on board)—It includes all charges up to the loading of goods on board the ship and export duty, if any. It is the aggregate of F.A.S. price, ship-loading charge, and export duty.

C. F. (Cost and freight)—It covers all costs and charges for bringing the goods up to the port of destination, except that of insurance.

C.I.F. (Cost, insurance and freight)—It adds the cost of marine insurance to C.F. price.

Franco or Rendu—This price is inclusive of all charges and expenses for sending the goods to the buyer's place of business.

Price quotations and terms of trade are generally communicated through cable messages. As the cable rates are charged on the basis of ten-letter a word, merchants are required to condense their messages by using code words for making economy in communication cost. Several recognized codes with five-letter words are available for the purpose, such as the Bentley's, A.B.C.'s, Peterson's and others. The exporter may inform the importer separately the name of the code that he uses in communication. In this way, secrecy of messages can be maintained by the parties. In addition to the cable or telegraphic message, radiogram and overseas telephone services are now available between the advanced countries for a still more quick communication of messages.

EXPORT TRADE PROCEDURE

An export transaction passes through many steps, of which the important are : (1) receipt of indent from abroad, (2) shipping and credit enquiry, (3) packing and forwarding the goods, (4) observing customs formalities, (5) issuing Bill of Lading and freight note, (6) preparing shipping documents, (7) effecting marine insurance, and (8) securing payment for the goods.

Indent or Order. An indent is an offer made by a foreign merchant to buy goods, and when it is accepted by the exporter, it becomes an order to ship goods to a foreign land. An indent may be either '*open indent*' or '*closed indent*'. In the case of open indents, order emerges from the concurrence of parties over the terms of trade through repeated communication. But in the case of closed indents, the buyer makes a fixed offer indicating the price and the brand of goods which is to be accepted or rejected by the seller of goods. An indent usually contains all important particulars of the transaction, viz., descriptions

and price of the goods ; instruction for packing, forwarding and insuring ; method of payment ; and delivery date along with Import Licence details.

Shipping and Credit Enquiry. After the acceptance of orders, the exporter has to book space with a steamship company in advance to the actual sending of goods. The exporter is assured by the shipping company of the space through a '*shipping order*' which directs the captain of the ship to receive goods on board the vessel. Before sending goods, the exporter must also be satisfied with credit-worthiness of the importer. The buyer is generally required to open a letter of credit with a certain bank having branches in both the importing and exporting countries. Bank reference is the usual mode of credit information in foreign trade, though other methods are resorted to by parties in some cases.

Packing and Forwarding. Packing is of special importance in foreign trade. Goods must be securely packed by baling, trussing or casing in such a way that it ensures safety to the goods and economy in freight charges. Packed goods are required to be marked suitably for the purpose of identification. This marking is usually done by means of stencils, and it consists of names of the importer and the port of destination written within a symbol like triangles, rectangles or circles. Packed goods may be despatched to the port directly by the exporter or through a forwarding agent.

> **A forwarding agent** is an intermediary who renders a number of services to the exporter by way of lifting the goods from the place of business and placing them on board the ship. Forwarding agents attend to all customs details, meet packing requirements and relieve the exporter of the complications in foreign trade.

Customs Formalities. Customs formalities centre round two things, namely, (*a*) the payment of shipping charges at the Landing and Shipping Dues Office and (*b*) the record of export details and the payment of export duty, if any, at the Customs Office. For these purposes, the exporter is required to fill in *Shipping Bills or Customs Challans* in triplicate and *Export Permission Forms* (Application to Export) in duplicate, available from those offices. The Shipping Bill for Dutiable Goods differs from that for Free Goods. A Customs Export Pass is issued to the exporter who has gone through all such formalities.

Bill of Lading and Freight Note. When goods are delivered to the dock, a *Dock's Receipt* is given to the party. But when goods are placed

directly on board the vessel, a *Mate's Receipt* is issued. On the presentation of this receipt at the Shipping Company's Office, the exporter obtains a document which is known as *Bill of Lading.*

The Bill of Lading serves as an official receipt for goods, a contract to carry goods to the desired place as well as a document of title to goods on board the ship. Hence, the importer cannot take delivery of the goods without obtaining this vital document beforehand. Although it is not a negotiable instrument like cheques or bills of exchange, it is freely transferable by endorsement and delivery. To facilitate this transferability, the Bill of Lading should be a "clean bill", and not a foul one which lists some defects in the goods. The Bill of Lading is usually drawn up in sets of three, of which one copy is retained by the shipping company and the other two are sent to the importer through different mails.

The *Freight Note* is a bill for freight charges made out by the steamship company. Where the freight is to be paid by the importer at destination, the Bill of Lading is marked "freight forward", otherwise freight charges are collected before handing over the bill of lading to the party. In addition to the regular freight charge, another charge known as "primage" is made by the shipping company for supervision of loading work. This charge usually comes to about 10 per cent of freight charges.

Shipping Documents. *Commercial Invoice*—Export invoices are drawn up by the exporter in triplicate and sent to the parties concerned in the shipment. The trade invoice contains detailed description, quantity, and rate of goods as well as charges incurred therefor and prices of goods to be paid by the buyer. According to the terms of trade, different price quotations are made to cover varying charges, e.g., C.I.F., F.O.B., etc.

Consular Invoice—Customs regulations of many countries require consular invoice for the purpose of easy clearance of goods at the port of destination in the importing country. The invoice is made out by the Consul of the importing country stationed at the exporting country. Instead of making a separate invoice, the commercial invoice is generally signed by the Consul in token of his approval.

Certificate of Origin—Countries with bilateral or multilateral trade agreements require a Certificate of Origin concerning goods in addition to the consular invoice. This certificate of origin testifies the place of production of goods so as to make a preferential treatment in respect of customs duties. This certificate is usually given by the consul or other authorised person, or by the secretary of a chamber of commerce.

Marine Insurance. To provide against the perils of the sea, foreign shipment of goods is invariably covered by a marine insurance policy.

When an exporter makes a frequent and regular consignment of goods, he usually takes a floating policy for the whole year. Instead of taking different insurance covers for each consignment, all individual exports are covered by a policy and in terms of which a separate insurance certificate is issued for each lot of goods.

Securing Payment. The exporter can receive payment for the goods in three different ways, viz., documentary bills of exchanges, bank advances under hypothecation of shipping documents, and direct drafts on bankers.

Under the first method, the exporter draws a bill of exchange upon the importer and sends it along with other shipping documents to a banker in the importing country for presenting the bill to the buyer of goods. This bill of exchange may be D/P bills or D/A bills. In the case of D/P bills (documents against payment), documents are to be released by the banker on payment of bills either at the time of presentation or within a specified period. If the buyer fails to make payment, the banker is authorised to sell the goods on behalf of the exporter. In the case of D/A bills (documents against acceptance), the banker is instructed to hand over the shipping documents to the importer when he gives requisite acceptance on the bill of exchange. **Under the second method,** the exporter can get either the whole or an agreed percentage of the value of a shipment by pledging or hypothecating the documents with a banker having branches in the importing and exporting countries. This arrangement amounts to advances made by the banker who realizes the amount from the importer on a subsequent date. To cover the possible risk of non-payment on the part of the importer, the banker obtains a letter of hypothecation which empowers the bank to sell goods in the open market, if required. **Under the third method,** the banker accepts the bill, drawn by the exporter, on behalf of the importer. For this purpose, the importer is required to give an assurance to the bank that he will pay the amount to the banker before the bill becomes due for payment. After acceptance the bill is returned to the exporter who can discount the bill very easily, because of the better credit standing of the banking concern.

IMPORT TRADE PROCEDURE

Like the export trade, the import trade may be carried on directly by a buyer or through an intermediary. The intermediary in import trade are commission agents who are popularly known as indent firms. As already pointed out, intermediaries in foreign trade are gradually being eliminated by direct trading. Indent firms in our country indulge in making secret profits at the cost of the importer and a number of other abuses have cropped up in the system. The major steps in import trade may be stated as follows :

1. **Indent or Order.** The importer has to send an order specifying

the important terms and conditions of the transaction. Indents may be either open or closed. In the case of open indents, no particulars regarding the source of purchase, the brand of goods or the price to be paid for them are indicated in the indent. The terms of the transaction are finally settled after making repeated communication between the parties. But in the case of closed indents, all particulars like the brand name of manufactured goods, specific prices and other information concerning the order are given in the indent. Usually, indents specify all such details as instructions for packing, shipping, invoicing or insuring, methods of payment, time of shipment, port of destination, etc.

2. **Letter of Credit and Exchange Booking.** In import trade, the importer has to prove his credit-worthiness to the foreign exporter who may demand a certain amount of deposit or even the full payment of price before the shipment of goods. For this purpose, the importer arranges with a local banker for issuing a letter of credit in favour of the exporter. This type of credit is usually confirmed and irrevocable in character. When the reputation of the importer is high, a mere bank reference may be adequate for the purpose. As regards the supply of foreign currencies at a fixed rate, the importer makes a forward purchase of foreign currencies so as to avoid unfavourable fluctuation in exchange rates.

3. **Advice Note and Documentary Bills.** After the shipment of goods, the exporter sends an advice note intimating the despatch of goods and the probable date of the ship's arrival at the port of destination. The advice note is followed by documentary bills of exchange which are usually presented by a banker for payment or acceptance, as they may be D/P or D/A bills. The importer gets the relevant shipping documents from the banker in order to take delivery of goods on their arrival.

4. **Customs and Clearing Formalities.** On the arrival of goods at a port, the master of the ship has to give within 24 hours a report known as "*Ship's Report*" to the customs authority. This report is intended to secure complete information in respect of the ship and its contents. Similarly the importer is required to submit a statement called "Bill of Sight", giving a detailed description of goods. Where these details cannot be given, the importer makes a declaration to that effect and customs authorities get the Bill of Sight completed after physical inspection and examination of the imported goods.

For releasing the goods, the importer has to fill in two sets of forms, viz., Bill of Entry in triplicate and Application to Import in duplicate and present them at both the Landing and Shipping Dues Office as

well as at the Customs Office. The former office collects the Port Commissioner's landing charges and the latter office collects the import duty, if any. There are different "Bills of Entry" for free goods required for use or export, for dutiable goods required for consumption or export and for dutiable goods that are to be bonded. When an incoming vessel has discharged her cargo and she has been thoroughly searched or rummaged, a certificate known as "Clearance Inwards" is issued by the customs authorities to indicate that all customs formalities have been duly complied with.

When the freight is payable by the importer and the bill of lading is marked 'freight forward', the importer cannot unload goods from the ship without making payment of freight charges. The shipping company issues a delivery order or endorses the bill of lading for delivery when freight charges are duly paid by the importer. *Clearing agents* are usually engaged by the importer to avoid the difficulties and complications of clearing formalities. These agents go through the customs details and deliver the goods at the importer's warehouse in return for a certain commission.

SOME ASPECTS OF FOREIGN TRADE

Customs Duties. Customs duties are usually imposed on three different considerations—*revenue, protection and bargaining*. Revenue tariff is imposed on luxury goods and other non-essential items for the purpose of earning some income to the exchequer, and hence quantitative restrictions of imports are not aimed at.

Protective tariff is levied for sheltering the home industries against the onslaught of foreign competition. It shuts out the import of specified goods into the country. Bargaining tariff is levied with the object of fostering diplomatic relations with other countries. It is generally associated with the conclusion of bilateral trade agreements between two countries or multilateral agreements with several countries. From an enhanced general tariff rate meant for all countries, special concessions are allowed to different countries on the basis of trade agreements.

Tariff rates may be of two types—*Specific* and *ad valorem*. A specific duty is a fixed charge of so many rupees for each unit of goods expressed in terms of volume, weight or measure. The value of the shipment is immaterial in the case of specific duties. But the value of goods is made the basis of charging *ad valorem* duty. A certain percentage of the value of goods is charged as duty. *Ad valorem* duty charges vary with changes in the value of goods from time to time, although the percentage is kept fixed. Hence, an element of uncertainty creeps into the taxation matter. As regards the rates of duty on a parti-

cular product with different grades, varieties, parts or sizes, a basic scale is fixed along with differentials for covering all possible variations.

Bonded Warehouse. The bonded warehouse is licensed to keep imported goods in storage before the payment of customs duty. The warehouse is licensed by the Government and a strict vigilance is kept over it by the Customs Authorities. It renders a number of services to the importer of goods. When goods are imported for the purpose of re-exportation the importer can avoid the trouble of paying import duty and claiming customs drawback on their further shipment to other countries. The importer is permitted to divide, mix, pack or do some other things concerning the goods when they are in bonded warehouse. By this process, marketing of goods is greatly facilitated. The importer can also arrange for the sale of goods by showing them to the prospective buyer. The greatest benefit is that the importer is not required to pay the entire amount of duty at one time. He can take delivery of goods in different lots, and the proportionate duty is paid on the quantity or value of goods taken out from the bonded warehouse. The importer can effect economy in transport cost, storage cost and is assured of safe keeping of goods. Moreover, goods kept in a bonded warehouse form an excellent collateral for bank credit. Bonded warehouse can also be utilized by home producer for the payment of excise duty in instalments. Besides the bonded warehouse, the Dock Authorities maintain duty-paid warehouses which can be utilized by importers for storage purposes.

Chartering of Ships. A ship can be hired in part or in whole for a particular voyage or for a fixed time for the purpose of carrying goods. Such hiring of ship under an agreement is known as ship chartering. Ship charters may be voyage charters for one or more voyages or time charters for the use of the ship during a specified time. The charter agreement or charterparty as it is alternatively called, contains a number of clauses, namely, (*a*) the names of parties, (*b*) the class of charter, (*c*) seaworthiness of the ship, (*d*) the quantity of goods to be placed on the ship, (*e*) freight charges along with a dead or minimum freight, (*f*) the number of lay days for loading and unloading, (*g*) the amount of despatch and demurrage money, (*h*) the place at which the ship is available, (*i*) the name, nationality and type of the ship, (*j*) the manner of loading or unloading and the responsibilities of the charterer and shipowners thereto, and (*k*) the excepted perils like the acts of god, barratry, etc. Certain fixed days called "*lay days*" are allowed for loading and unloading operations without making any charge therefor. Penalty is imposed for extra days required for

loading and unloading by way of *demurrage*, while a concession is given by way of *despatch* money for the saving of lay days.

There are certain implied terms in every charterparty. *First*, the ship must be seaworthy at the time of sailing, i.e. before the commencement of voyage ; otherwise the charterer is at liberty to repudiate the contract for hiring the ship. But if the ship becomes unseaworthy after the commencement of voyage, the charterer can only claim damages for loss suffered by him. The condition of seaworthiness implies that the ship has been constructed properly, that its machinery is in running order, and that it is properly loaded and has been provided with other facilities for undertaking the voyage. *Secondly*, the ship must be ready and prepared to commence its journey without causing unreasonable delay. *Thirdly*, the ship must not deviate from its scheduled route in the course of voyage. Deviation is only permitted for some special reasons like the safety of the ship, or its cargo and property or of its passengers. *Fourthly*, the shipowner must place the ship at the agreed port of loading. *Finally*, the charterer must not place any dangerous cargo or unlawful merchandise on board the ship without the knowledge of the shipowner.

Although both charterparty and bill of lading are contracts of affreightment, there are many points of distinction between the two. (1) A bill of lading is a receipt for goods as well as a document of title to goods. A charterparty is neither a receipt for goods nor a document of title to goods. (2) A charterparty involves the hire of a ship for carrying men or materials on behalf of the charterer himself as well as on behalf of other parties. The bill of lading has nothing to do with the hire of the ship, whether in full or in part. (3) The bill of lading is obtained for the shipment of those goods which require a small part of the ship's total carrying capacity. In contrast, charterparty is arranged in those cases where the cargo requires the total shipping space or a sizeable portion thereof. Tramp ships usually make charter agreements for carrying cargo over non-scheduled routes. Liners issue bill of lading for carrying cargo in their scheduled voyages. (4) The implied terms of the contract vary between the charterparty and the bill of lading. (5) The clauses of the charterparty are different from those of the bill of lading.

Letters of Credit. Letters of credit are widely used for making payments in foreign trade. The Export Credit Guarantee Committee has estimated that sixty per cent of country's export trade is covered by the banks' letters of credit. A letter of credit may be defined as an order issued by a bank in the importing country upon one of its branches or agents in the exporting country for allowing a specified amount of credit for a fixed period to the beneficiary, named and identified in the

letter of credit, as per terms and conditions contained therein. The importer procures the letter of credit from the issuing banker and sends it to the exporter who can obtain such credit against the shipment of goods from the paying banker. However, letters of credit can also be drawn by a commercial house on some other party, and they may be used for making payments in internal trade too. Letters of credit are not negotiable instruments, and accordingly the paying banker must be careful about the identity of the beneficiary who is usually the exporter. For making payments in foreign trade, letters of credit partake of the character of confirmed and irrevocable ones. Irrevocable letters of credit cannot be cancelled without the consent of the beneficiary ; and the confirmed letter of credit implies that paying bank confirms the direction of the issuing bank as to the grant of requisite amount of credit.

Classification of letters of credit—Letters of credit may be of diverse types. Some important types of them may be stated as follows : (1) A clean or open letter of credit is one which does not stipulate any conditions for extending credit facilities and which does not call for offering any security to the issuing banker. (2) A qualified or conditional letter of credit is the reverse of the first type, and it lays down certain conditions in regard to the extension of credit facilities. (3) A documentary letter of credit calls on the beneficiary to submit the relevant shipping documents to the paying banker for obtaining credit against the letter of credit. The shipping documents are then forwarded by the paying banker to the issuing banker in the importing country and the issuing banker releases the shipping documents to the importer on his executing a letter of hypothecation for the purpose of enabling the importer to take delivery of the imported goods. (4) A circular letter of credit is issued by a bank, requesting one of its branches, agents or correspondents in foreign countries, for honouring bills or drafts presented by the holder of the letter of credit.

CHAPTER 33

COMMODITY EXCHANGES AND FUTURES TRADING

NATURE OF COMMODITY EXCHANGES

A commodity exchange is an organized market for dealing in certain commodities and is set up by an association of dealers under definite rules, regulations and bye-laws. It provides a market place where the members meet at fixed times and transact business according to the rules laid down by the exchange. Besides the provision of a trading place and the regulation of members' dealings, it determines membership of the exchange, settles any dispute between members by arbitration, fixes the grade of commodities handled, and collects and disseminates market information.

Commodity exchange may be either general or special. A general exchange is organized to facilitate dealings in a wide variety of products, while members of special commodity exchanges confine their transactions to a single product. A large number of products can be traded on the floor of these exchanges, namely, natural products of the soil like wheat, cotton, jute, tea, oilseeds, etc., or mining products like lead, copper and other non-ferrous metals, or manufactured products like jute goods, cotton goods, butter, sugar, hides and skin, etc. In our country, trading is confined to a limited number of commodities, viz., cotton, wheat, raw jute, jute goods, tea and oilseeds. All commodities are not capable of being quoted on these exchanges. Trading on the exchange becomes possible only when commodities possess the following five characteristics :

Homogeneous character—Commodities must be homogeneous in character so that there is nothing to choose between two units of the same product. Commodities must be of the same kind and nature and they must mean the same thing to all persons at different times and places. That is, they should be interchangeable between two or more lots.

Standardized and graded products—Commodities must be capable of being divided into certain well-recognized grades so far as their quality is concerned. As dealings are made on the basis of either samples or grades, the parties are required to be assured of the quality of products.

Non-perishable products—Perishable products cannot form the subject matter of dealing on commodity exchanges. Particularly in the

case of contracts with a long delivery period, those commodities may become useless which are of a perishable character.

Large and steady demand—The demand for the product should be large so as to permit frequent dealings and to ensure a continuous market. The constant buying and selling in large volumes make the exchange a perfect market for commodities.

Supply must remain uncontrolled—The supply of the commodity must come directly to the market and must not be controlled by the State or other private bodies. Only when the supply is not controlled, the commodity is characterised by price fluctuations, and speculators can operate in the market to eliminate the price fluctuation.

CASH AND FUTURES MARKETS

As to the nature of transactions, the commodity exchange may be either a cash market, a futures market or a combined cash and futures market. The commodity exchange is essentially a market for futures transactions which have bestowed upon it a leading place in the marketing system. A thorough knowlege of the nature of these transactions is essential for understanding the intricacies of a commodity exchange.

Cash transactions or cash contracts are permitted in the cash market, while futures contracts or simply 'futures' are reserved for futures market only. Cash markets are known by various names like physical, actual, ready, spot etc. Likewise, futures markets are known by paper, exchange or contract markets. Cash contracts in goods imply the liquidation of transaction by the payment of cash on the part of buyers and by the delivery of goods on the part of sellers. When delivery and payment are made immediately or within a short period, cash contracts are referred to as "spot contracts". But when delivery and payment are delayed, cash contracts become what are known as "forward contracts" or contracts for forward delivery. As pointed out by the joint American authors, "Cash or physical market not only deals in spot lot ready for immediate delivery, but also trades in contracts for forward deliveries of the commodity".[1] However forward contracts must not be confused with futures contracts which are an entirely different class of contracts permitted on commodity exchanges only. Cash contracts, whether spot or forward, are made not only on the floor of exchanges, but they are also widely made outside the exchanges for the actual sale of goods. Futures contracts on the other hand, can only be entered into through an organized commodity exchange and they can never be made outside the exchange. From the standpoint of delivery period, they do not provide any clue for drawing a line of

[1] Baer and Saxon, *Commodity Exchanges & Futures Trading*, p. 126.

demarcation between cash and futures contracts. As a matter of fact, some futures contract may require settlement within a short period, say 20 to 30 days, whereas cash contracts may provide for delivery after 2 or 3 months. In short, a futures contract does not indicate futurity of settlement in all cases.

Features of Futures Contracts. For clarity of understanding, the peculiar characteristics of futures contracts are stated by way of contrast to cash contracts in the following manner :

1. *Object*—The object of futures contracts is to facilitate speculative and hedging transactions. The actual marketing of commodities and their physical transfer from the seller to the buyer are never intended by the parties to futures transactions. Hence, these transactions are confined to speculators and hedgers who adjust only price differences at the time of settlement. But cash contracts are invariably made for the purpose of selling the commodity and giving delivery promptly or on a future date.

2. *Parties to the contract*—A futures contract is made between persons who must be members of the exchange, although they may act either as principals or brokers. Cash contracts may be made directly by the producer or through brokers.

3. *Trading units*—In the case of futures transactions, commodity exchanges prescribe certain fixed quantity of goods as their units of trading. When, for example, an exchange fixes 100 tonnes as its unit of trading, members must make transactions in terms of complete one unit, two units, and so on. A fractional part of a unit can never be used to make transactions. The size of the unit may vary between exchanges, although it is fixed and certain in the case of an individual exchange. The size of the unit is fixed in such a way as to render maximum services to manufacturers who enter into hedge contracts. Any small size of units encourages irresponsible speculation but a large size prevents small-scale manufacturers from trading on exchanges. Hence, a moderate quantity is usually fixed as the unit of transaction. Cash contracts, on the contrary, can be made in any quantity, and the actual quantity must always be mentioned in the contract. Futures contracts do not contain any term relating to the quantity of goods, but only the number of units to be sold or purchased.

4. *Grade of product*—Futures contracts need not provide for the quality or grade of products, as all contracts must be made on the basis of one fixed grade which is called "basis grade" or "contract grade". The exchange fixes the contract grade which is supposed to cover the major portion of supply of a commodity in the country. Although futures contracts are made on the basis of contract grade, sellers have always the option to give delivery or to make settlement in some other

grades which are known as "tenderable grades". These permissible grades are allowed by exchanges with a view to preventing the possibility of 'corners' and 'squeezes' by controlling the supply of contract grade products. Along with the fixation of tenderable grades, price differentials or tendering differences between the contract grade and other grades are determined so as to adjust the price of a superior or of an inferior quality of products. In the case of cash contracts, the exact quality or grade of product must be stipulated by the parties in their terms of contracts, and delivery must be given in that specified grade.

5. *Margin requirements*—The margin requirement is an inherent provision of all futures contracts. Both the parties are required to deposit a certain percentage of the contract price as the guarantee for honouring their obligations. The margin system is designed to prevent the parties from making default. Cash contracts do not usually require any margin, specially when the parties are known to each other. Even where a cash contract calls for margin, the margin money is only given by the buyer of commodities, and the seller is not required to provide any margin.

6. *Trading months*—Futures contracts on most exchanges are confined to certain months of the year. As regards the selection of months as well as the number of months, the practice varies from exchange to exchange but there are certain fixed trading months for an individual exchange. Out of twelve months in a year, four to six months are usually adopted as trading months. Futures contracts can only be made for settlement in specified trading months. Cash contracts obviously cannot be confined to any month, and they can be made and settled in all the months.

7. *Delivery time*—In a futures contract, the seller has the option to choose the exact date of delivery within a designated trading month. In between the first and last dates of the month, delivery may be given or settlement may be made by the seller on any date he likes. Cash contracts usually call for delivery on fixed dates.

8. *Delivery centres*—Futures contracts provide for effecting delivery at a particular centre. But the seller has an option to give delivery at some other specified centres which are known as upcountry centres. However, when the seller wants to give delivery at centres other than the one specified in the futures contract, he has to bear the transport charges at prescribed rates for bringing the commodity to the centre referred to in the contract.

9. *Trading methods*—The trading method of futures contracts is entirely different from that of cash contracts. Where a particular exchange permits both cash and futures contracts in the same commodity, a different time and place must be prescribed for each class of contracts. Futures contracts are made subject to the rules and regula-

tions of the exchange and are transacted at the ring or pit of the exchange. (The detailed trading procedure has been discussed at a later part of this Chapter.) Cash contracts may or may not be subject to the rules of the exchange, and they are transacted either at the exchange tables or privately. Unlike cash contract, all disputes in futures contracts are required to be settled by arbitration.

ORGANIZATION AND OPERATION OF EXCHANGES

Constitution. Commodity exchanges are generally organized as incorporated bodies with fixed rules and regulations for the conduct of their operations. The majority of exchanges in our country fall into the category of corporate bodies formed as either profit sharing or non-profit sharing associations. Non-profit sharing associations are the leading exchanges situated in important industrial centres of the country. Profit-sharing associations are comparatively unimportant exchanges and they have been established in the interior parts of the country for trading in wheat, cotton, and some other staple farm products. Besides, there are many unregistered exchanges scattered throughout the country.

Of the commodity exchanges in our country, some are organized under strict rules and regulations, some are partly organized and others are completely unorganized. The marketing aspect was entirely neglected by the Government in the past. As a result, too many so-called markets cropped up in the country to satisfy the speculative urge of the members of some exchanges or to exploit the primary producers of agricultural commodities. There was unhealthy competition between exchanges which did not hesitate to relax rules and regulations for the purpose of securing additional business. However, a serious attempt is now being made by the Government to terminate this sorry state of affairs. The Forward Contracts (Regulation) Act, 1952 which has come into force from August 24, 1953, permits only recognized futures markets to operate in the country. Futures trading has been banned in many cases. Cash markets are being reorganized as regulated markets to improve their methods of trading. Of the total 2,500 markets, the number of regulated markets increased from 470 in 1955-56 to 725 in 1960-61.

Management. Management of the exchanges is vested in the Board of Directors or the Managing Committee assisted by a number of Standing Committees. The Board of Directors exercises an overall supervision over the working of exchanges and frames necessary rules and bye-laws for the conduct of operations. The rules are enforced by different Standing Committees.

Membership. As transactions in a futures market are confined to members only, there are almost the same restrictions on membership as are to be found in the case of a stock exchange. Members may deal on their own account or they may act in the capacity of brokers for others. Members sell goods for producers, wholesalers or foreign importers, and they buy goods for exporters, manufacturers or speculators. Manufacturers and exporters often become members of the exchange for buying their own requirements, thereby avoiding brokerage payment to others. The members of a futures market are either speculators or hedgers. But a commodity exchange organized for cash trading does not place so much restrictions on membership, and primary producers are often allowed to arrange for the direct sale of their products.

Methods of Trading. The method of cash trading is different from that of futures trading. Under the Forward Contracts (Regulation) Act, 1952, commodity markets organized for cash trading in our country can only permit spot contracts that call for delivery of specific goods and payment of price from the original parties within a period of 11 days from the date of the contract. Transferable spot contracts, forward contracts and futures contracts have been enmeshed together, and they have been brought under the purview of the Forward Contracts (Regulation) Act.

Spot trading—Spot trading is usually made around the table which displays the sample of products. Buyers and sellers make their bids and offers by the call method which amounts to shouting or openly declaring their individual prices. The presiding officer closes the bargain when the bid price equals the offering price. The auction method of sale is a variant of the call method and such method is also adopted by some exchanges for making cash contracts. Some unorganized exchanges permit their members to make bargains privately under the cover of a cloth ; but this practice is highly objectionable and is not worth the adoption of an organized market. Many commodities that previously used to be sold outside the exchange are nowadays being traded on the floor of exchanges. There are two advantages which have brought about this change in marketing method. Because of the large volume of trading, prices are set publicly at a fair level by the interaction of demand and supply. Secondly, reliable market information as to supply position, demand position and other pertinent data become known to the parties. But if the volume of trading is not sufficient, members may manipulate or control the prices against the interest of primary producers.

Futures trading—The mechanism of futures trading has ensured the most satisfactory and fair method of trading in commodity markets. Futures trading is conducted across the ring or pit which is a fenced cir-

cular place at the exchange. Buyers and sellers gather around the outskirt of the ring so that they can see one another for the purpose of making effective bargains. The caller of the exchange and his staff take their position within the ring. With the sounding of a bell or gong, the trading machinery is set in motion. The caller announces the first trading month, for which offers and bids are made by the members. At the first round of the call, no transactions are generally effected. Buyers and sellers wait and look for the second, or even the third round call on some exchanges. In each round of calls, when all offers and bids for the first trading month have been made and recorded, the caller announces the next trading month for making bids and offers relating to that month. The process is continued until all the trading months are covered in each round. The call for a round is commenced at the fixed time and is similarly gone through covering all the trading months. Offers and bids are invariably made by outcry along with certain familiar motions and gestures or with violent wavings of hands. This system of bargaining is what is known as "call method".

Futures trading present a scene of utter confusion and even laughter to uninformed persons. All the members go on shouting simultaneously to make their prices heard and accepted. A hundred offers and bids are made at the same time. Members, being unmindful of what others say, go on pressing their bids or offers for several times. To be sure, they have no time to see or hear anything, else the business may slip away from their hands. To make the situation worse, telephone connections of members with their offices bring in important news to excite them to the extreme. Nevertheless, transactions are carried on very smoothly and fairly. Motion and gestures are merely made to draw attention of a buyer or seller with whom transactions can be made. Every transaction along with the price at which it is effected is recorded immediately on the boards of the exchange, and it is flashed out daily in the newspapers, both within and outside the country. As the prices are set publicly by outcry across the ring, they become just and equitable to all persons. Rules of exchange regulate the mode of trading as well as of acceptance of bids or offers. A common rule is that an offer to sell at a certain price goes to the member who first meets the price. Similarly, bid to buy at a certain price is accepted by the member who first meets the conditions of both quantity and price.

NATURE AND FUNCTIONS OF SPECULATION

Futures trading comprises speculative transactions and hedging transactions. The primary object of futures trading is to provide a ready market for hedge contracts. But the number of hedge contracts cannot be so large as to keep the exchange busy for all the time and to make

it a continuous market for commodities. Certain amount of speculation becomes essential for the working of a futures market. In short, *speculation without hedging is useless, but hedging without speculation is impossible.* This explains the necessity and importance of speculation in a commodity market. Speculation renders a number of important benefits : (*a*) it aids in stabilizing prices between periods and in regulating the rate of consumption of available products ; (*b*) it equalises prices between different markets and directs the flow of products from one centre to another ; (*c*) it transfers the risks from manufacturers to professional risk-takers and makes manufacturing a smooth operation ; (*d*) it discounts future prices and promotes the establishment of an orderly price structure ; (*e*) it establishes an international market for commodities ; and (*f*) it imparts liquidity and price continuity to the commodities.

Kinds of Speculative Transactions. The following are the important types of speculative dealings :

Speculative buying and selling—Like stock exchange speculation the bulls and bears carry on their speculative-buying and short-selling transactions in futures markets. The bull speculator, expecting the price to rise in future, buys at the present price with the object of selling commodities at a higher price on a future date. He buys for the "long market". Short selling is indulged in by bears who sell commodities that they do not as yet possess. Short selling is made the target of greater assaults than speculative buying. But it is the short seller who reduces the peaks and valleys of price fluctuations. Short selling is impossible without an organized futures market, while speculative buying can be made even outside the exchange. Short selling is criticised because a futures market can be easily manipulated or cornered by these transactions. However, this risk can be minimised by adopting remedies like limitation of the volume of trading, limitation of price fluctuation in a single day, suspension of the market, and price fixation for settling outstanding contracts.

Straddle and arbitrage—The speculative transaction that is directed to eliminate price differences between the spot and futures markets on the same commodity exchange is known as straddling or spreading transaction. As already pointed out, a commodity market may be organized for both spot trading and futures trading in the same commodity. When such a situation prevails, there should remain a constant parity between the spot price and the futures price. If this price spread or price parity is disturbed for any reason, the speculators become active to restore the normal price through straddling transactions.

Arbitrage operations are much more important and wider in scope

in commodity markets than in stock markets. Staple commodities like wheat and cotton are dealt in on international level and they have a world market. Prices of these commodities in different countries are only subject to the difference caused by the cost of transport, tariff and exchange rate, otherwise they remain at the same level. This situation is brought about by the speculators' arbitrage operations. Arbitrage transactions eliminate price differences between two markets situated either in the same country or in two different countries.

IMPORTANCE OF HEDGING

It is hedging transactions which justify the existence of a futures market. Hedging makes manufacturing operations less risky and provides the manufacturer with some sort of price insurance. Since production is now carried on much in advance of consumption, and since the price of finished products is liable to fluctuations along with the price of raw materials, manufacturing operations become risky, uncertain and unprofitable in many cases. Hedging relieves the manufacturer of the anxiety about price fluctuations and guarantees him the normal manufacturing or trading profits. As the price of flour moves with the price of wheat, the manufacturer may be forced to reduce the price of that flour which has been produced from wheat purchased at higher prices six months back. That is, hedging may be defined as two offsetting transactions in the same commodity, one purchase or sale in the spot market and another sale or purchase in the futures market, for neutralizing the loss or gain arising from either of them over a period due to adverse price fluctuations.

This risk of price fluctuations can be insured by the manufacturer through his buying of required raw materials in the spot market and selling of an equal quantity of the same materials in the futures market. The simultaneous purchase and sale are likely to offset any loss or gain arising out of price fluctuations. The chief advantage of hedging lies in securing the benefits of price stability by shifting the risk to professional risk-takers. Price stability brings a number of other advantages like reduced prices of finished goods owing to the availability of raw materials at fixed prices, a steady production flow of goods, and an enhanced collateral value of materials for securing loans.

Limitations of Hedging. Hedging is not a perfect form of price insurance, although much has been said in its favour. There are four important limitations that have made hedging an ineffective device of price insurance. *First*, with a view to affording complete protection against price changes, prices in the spot and futures markets must move identically, and the price spread between two markets must remain at

the constant level. As we have seen earlier, the price spread does not remain constant and straddling operations become necessary as corrective measures. Consequently, hedging fails to give protection to that extent by which prices stay out of normal level. *Secondly*, prices of different grades of a commodity do not usually change in exact proportion. Selling in the futures market must be done in the contract or basis grade, while corresponding buying in the spot market may be done in any grade which is neither a contract grade nor a tenderable grade. As a result, hedging may not compensate the loss arising from price changes. *Thirdly,* as a protective device, hedging requires the purchase and sale of an equal quantity of commodities in spot and futures markets. Futures trading must be done in quantities as fixed by the unit of transactions. Manufacturers' requirement of commodities may not tally with the size of the unit of trading. For example, if the unit of trading is 100 tonnes in a futures market and the manufacturer requires 150 tonnes for his current production, neutralizing sale and purchase of equal quantity are not feasible. Accordingly, hedging results in loss or greater profits on the part of manufacturers. *Fourthly,* hedging is based on the theory that prices of finished products will move with the prices of raw materials. In other words, it is assumed that the price of raw materials is the only determinant of the total cost of production, and hence of prices. When the cost of production rises due to an increase in labour cost and other expenses, hedging absolutely fails to be of any help to the manufacturer.

For these limitations, it is commonly suggested that a direct price insurance with insurance companies would give a better protection to manufacturers as compared with hedging. Insurance policies no doubt require premium payments, but hedging also involves some expenses for brokerage payments and margin requirements. When hedging fails to realize its objective, the question of a cheaper or costlier form of insurance becomes irrelevant, and even the small amount incurred on hedging may be regarded as a sheer waste.

EVILS OF FUTURES TRADING

The primary object of futures trading is to provide the manufacturer with a hedge market. The facility of hedge contracts may be lost in those cases where the futures transactions are characterized by gambling and price manipulation. Gambling is the perverted use of speculation by persons who are either inexperienced or poor in resources. The inexperienced person, or "lamb" as he is called, cannot exert any levelling influence on prices. On the contrary, he disturbs the normal trend of prices and creates difficulties for the manufacturer and other genuine traders. Unlike the speculator, he does not increase the poten-

tial demand or supply of commodities. He renders no service to the society so as to bring recognition for his activities. Again, speculative trading with an inadequate capital often results in gambling, since the traders cannot fulfil their obligations. Default on the part of traders exercises a demoralising and injurious influence on the market. Futures trading fails to give any protection to the manufacturer. However, this evil can be guarded against by arranging for a higher margin requirement.

The other evil of price manipulation appears in the market because of the concerted buying or selling of commodities by traders. With a view to deriving higher profit margins, prices are forced to deviate from their normal levels by manipulative activities. Manipulation is usually done by two methods, namely, spreading of false news and making of false transactions. Through the dissemination of false news about market conditions, market activities may be influenced by a group of traders. Alternatively, token sales, or even fictitious sales, may be made by the manipulators for the sake of convincing others. Besides *wash sales*, there are *matched orders* for false buying. When the futures market is entirely controlled by manipulators, the market comes under the grip of a "*corner*". In cases of partial control, the market is said to be under the influence of a "*squeeze*". Whatever might be the extent of control, full or partial, the futures market becomes useless for hedging purposes.

REGULATION OF FUTURES TRADING AND THE FORWARD CONTRACTS (REG.) ACT, 1952

With a view to regulating futures trading and making the futures market helpful for hedging transactions, the Forward Contracts (Regulation) Act, 1952 has come into force with effect from August 24, 1953. The Act has, however, been amended in 1953, 1957 and 1960. Before the enforcement of this Act, futures trading in some commodities was prohibited during the war period under the Defence of India Rules and, in the postwar period, under provisions of the Essential Supplies Act of 1946. The Forward Contracts (Regulation) Act aims at establishing well-organized futures markets in different centres of the country. A Forward Markets Commission, composed of two to four members, has been constituted to give effect to the regulatory measures. The Commission is the main functionary in the hands of the Government for realizing the objectives of the Act. By the end of 1960, 26 markets have been recognized in 13 different commodities.

At present, the regulatory measures apply to a number of commodities like wheat, gram, cotton and cotton yarn, raw jute and jute goods, edible oilseeds and oils, seedlac and shellac, spices, etc. In addition to

the specified commodities, provisions of the Act can be extended in future to other commodities. In the sphere of commodities under regulation, all non-transferable specific delivery contracts are free from regulation, and forward contracts only are liable to regulation under the Act.

Non-transferable specific delivery contracts mean transactions which call for actual delivery of goods and the payment of price from the original sellers and buyers without any transference of their rights and obligations under the contract. Except in the case of ready delivery contracts, i.e. in contracts where the period of delivery as well as the payment of price does not exceed 11 days from the date of transactions, all other contracts have been labelled in the Act as forward contracts. Forward contracts are intended to cover even all futures contracts. It would have been much more appropriate and meaningful to give the title of this regulation as Futures Contracts (Reg.) Act rather than Forward Contracts (Reg.) Act. As it stands, however, transferable spot contracts, forward contracts and futures contracts are under the purview of the Act, and non-transferable cash contracts alone are excluded from regulation.

All regulated contracts are to be made on the floor of recognized commodity exchanges and their dealings elsewhere have been prohibited. Recognition is confined to a limited number of exchanges and is restricted to one association for any specified commodity in a prescribed area. All option dealings in commodities have been declared illegal. The Government has reserved the power to regulate even the non-transferable specific delivery contracts by future notification. By amending the Act in 1960 and enforcing the same with effect from December 28, 1960, *kerb trading* beyond official hours, *dabba trading* and other forms of undesirable trading have been declared illegal. Provision has also been made in the Amending Act for penalty by way of fines or imprisonment for the first offence and imprisonment as well as fines for subsequent offences under the Act.

Other provisions of the Act may be studied under the following three heads :

A. *Recognition of commodity exchanges*—On the recommendation of the Forward Markets Commission, the Central Government may grant recognition to a particular association in a prescribed area, when such recognition becomes necessary in the interest of trade as well as of public good. For the purpose of recognition, exchanges are required to frame rules and bye-laws with the previous approval of the Central Government. The governing body of the recognized exchanges must be constituted by the appointment of a person as Government representative and a maximum of three persons representing outside interest.

B. *Powers of the Government over recognized exchanges*—The

Central Government can direct the exchanges to make, alter or modify the existing rules and bye-laws. In order to deal with abnormal situations, the Government is empowered to withdraw recognition, to supersede the governing body and to suspend the business of any recognized association up to 7 days. Moreover, the Government can call for information and require submission of periodical returns and annual reports relating to the affairs of an association or of its members. The day-to-day working of all recognized exchanges has been placed under the close supervision of the Forward Markets Commission.

C. *Matters to be regulated through bye-laws*—Futures trading must be covered by a specified margin and the rate of margin should be fixed from time to time by the association. Clearing of transaction should be made at least once in every fortnight. The bye-laws should also provide for the setting up of clearing houses. Any contravention of bye-laws should be made subject to an adequate penalty, and the members would be required to inform the association of the volume of daily business done by them. A number of other aspects like the fixation of market rates, of contract and tenderable grades, of scale of brokerage, and the prevention of corners or squeezes are to be regulated through the bye-laws.

SOME ORGANIZED COMMODITY MARKETS

Tea Auction. Tea is mostly marketed in Calcutta under the auction method of sales, and a small quantity is sold by private negotiation. The Calcutta Tea Traders' Association is an organization set up by four non-Indian and two Indian brokers for conducting the auction sale. More than 95% of the business is handled by the foreign brokers and the Indian brokers play an insignificant role in tea marketing. The Calcutta tea market is a spot market, not a futures market in tea. Accordingly, delivery and payment are to be completed within 7 days or less after the auction sale, and samples are to be shown to the prospective buyers. The transaction must be made through members of the exchange who usually act as brokers for both the buyers and the sellers. The auctions are held twice in a week, Monday is reserved for leaf grade and Wednesday for dust grade. Because of the seasonal production of tea in North India, auctions are generally confined to 10 months from June to March. The greater part of the produce is uptill now sent to the London Auction or to other foreign markets for sale by private negotiation. However, attempts are being made to increase the business of the Calcutta Exchange through the expansion of warehousing facilities in Calcutta. To improve matters on trading, the Plantation Enquiry Committee has recommended the segregation of buying brokers from selling brokers. The present brokerage charge

of 1% from the sellers and Rs. 2.75 per quintal from the buyers appears to be rather high. Another tea auction in our country is held at Cochin on similar lines with the Calcutta Tea Auction.

Raw Jute and Jute Goods. In order to check unrestrained speculation, forward trading in jute goods was banned from December 1952 under the West Bengal Jute Goods Act of 1950, and the Central Government prohibited forward contracts in raw jute with effect from October 1953. Since then, the question of regulating the Calcutta Exchange for forward trading was in the active consideration of the Government. On the report of the Forward Markets Commission, the Government of India decided in November 1956 to grant recognition to the East India Jute and Hessian Exchange Ltd., Calcutta for the purpose of forward trading in raw jute and jute goods within the city of Calcutta, and to ban such trading in other parts of the country. Accordingly, the Government of India granted recognition to the East India Jute and Hessian Exchange Ltd., Calcutta, with effect from March 29, 1958 for a period of three years. All futures trading in raw jute and jute goods is to be conducted only under the auspices of the Calcutta Exchange, the articles of association and bye-laws of which have been previously approved by the Government. All transferable specific delivery contracts in raw jute and jute goods were permitted outside the exchange for a limited period and they have now been brought under control. However, non-transferable specific delivery contracts are free from regulation throughout the country.

The articles and bye-laws of the exchange provide for making three standard contracts in respect of three different products, viz., hessian cloth, sacking bags and raw jute. Margin requirements have been imposed on the basis of member's net amount of outstanding business along with the provision for a free limit and a maximum limit for each product. The exchange fixes the contract grades and prices thereof and demands from every member an initial security deposit of Rs. 10,000 for trading in raw jute, Rs. 10,000 for trading in jute goods and Rs. 20,000 for trading in both. The clearing system calls for weekly settlement of transactions. Disputes between members are settled by arbitration through the good offices of the Bengal Chamber of Commerce and Industries.

Cotton. The East India Cotton Association Ltd., Bombay was reorganized and granted permission to commence futures trading in cotton with effect from June 1956. The cotton futures market has modified its articles and bye-laws in respect of four important matters : (*a*) two contract grades have been introduced, viz., one with Jarilla 25/32″ fine and another with Vijay 27/32″ fine instead of one basis

contract with Jarilla 13/16" fine. (*b*) Delivery months have been staggered considerably but confined to a limited number of months. Futures trading commenced in June 1956 with March 1957 delivery for Jarilla contract, and with April 1957 delivery for Vijay contract. (*c*) The clearing system has been improved and margin requirements have been tightened up. (*d*) The activities of the members have been placed under a greater measure of control through a comprehensive reporting arrangement.

The board of directors of the East India Cotton Association Ltd. is composed of 22 members having representation from members, brokers, growers, Government and other interests. In day-to-day operation, the board is assisted by five sub-committees, viz., the Daily Rates Committee, the Survey Committee, the Standards Committee, the Ring Committee and the Clearing House Committee.

Oilseeds. The Bombay Oilseeds and Oils Exchange Ltd. was recognized for futures trading in cottonseed with effect from October 30, 1956. Small cottonseed has been made the contract grade, the unit of trading has been fixed at 100 Khandies (1 Khandi=784 lbs.) and delivery months have been prescribed in February, May and September. Besides the Bombay Market, the Government of India granted recognition to the Central India Cotton Association Ltd., Indore, for futures trading in cotton and cottonseed for a period of three years in the first instance. This association has two trading rings, one at Indore for cotton, and the other at Ujjain for cotton and cottonseed.

For futures trading in oilseeds, a number of other associations have been recognized. Some of them include (1) the Bombay Oilseeds Exchange Ltd. in respect of castorseed, (2) the Saurashtra Oil and Oilseed Association Ltd., Rajkot in respect of groundnut and groundnut oil, (3) the Ahmedabad Seeds Merchants' Association in respect of castorseed and cottonseed, (4) the Adoni Groundnut Seeds and Oil Merchants' Association Ltd., in respect of groundnut oil, and (5) the Madras Oilseeds and Oils Exchange Ltd. in respect of groundnut oil.

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 28 : PRODUCT MARKETS AND MARKETING FUNCTIONS

1. What do you mean by marketing and what are the important activities involved in the marketing process? Discuss the requirements of assembling and dispersing in connection with buying and selling of goods.

*2. What do you know about the public warehouses that are being established in the country by the Central and State Warehousing Corporations? State briefly the advantages of such public warehouses.

*3. "For marketing products of manufacturing industries, branding is a more pertinent function than grading." In view of this statement, explain how branding differs from grading and why the manufacturers make use of branding.

4. What are the important considerations involved in the pricing of products? Explain the reasons for resorting to resale price maintenance by manufacturers of household consumption goods. Do you support such resale price maintenance in every situation?

5. What are the different types of fire insurance policy? Enumerate the main clauses of such a policy.

*6. What are the different types of marine insurance policy? Enumerate the main clauses of such a policy.

7. How does life insurance differ from other types of insurance? Indicate the manner by which life policies can be assigned. Explain how an assignment differs from nomination with regard to life insurance policies.

8. Write short notes on—(*a*) Packing and packaging, (*b*) Odd price marking, (*c*) Price lines, (*d*) Insurable interest, (*e*) Jettison, (*f*) Barratry, (*g*) Particular and general average loss, (*h*) Third party insurance, (*i*) Fidelity insurance, and (*j*) Lloyd's.

Chapter 29 : Transportation and Traffic Services

*9. Explain the functions and services of transport in the industrial and commercial development of a country.

10. What are the advantages of road transport over the railways? Explain the situations where airlines and pipelines provide the feasible means of transport.

11. Trace the growth of railways after the independence of the country. What are the future provisions for the development of railways in India?

12. Explain how goods have been classified in various ways from time to time by the railway authorities for fixing railway rates in India.

*13. What are the important principles of railway rates fixation? Why do the railways adopt the system of charging goods on the basis of "what the traffic will bear"?

*14. Explain the need for, and the means of rail-road co-ordination in India.

15. Trace the development of shipping lines in India with special reference to the recent formation of the Shipping Corporation of India Ltd. Indicate the target for shipping capacity during the Third Plan.

*16. What are the reasons for rendering the shipping competition more severe and devastating in character? Explain the important means by which this competition can be eliminated or reduced.

17. Explain the importance of coastal shipping in the economic development of the country. What are the handicaps to the growth of such shipping?

18. Trace the evolution of airlines in India and point out the reasons for nationalization of air transport. Give a brief idea of the operation of nationalized air services.

19. What do you mean by traffic management? What is the specialist

knowledge required on the part of a traffic manager? As a traffic manager, what particulars would you expect in a railway receipt, a bill of lading and a consignment note?

CHAPTER 30 : ADVERTISING AND SALES PROMOTION

20. Explain the role and significance of advertising and personal salesmanship in the present-day marketing system.

*21. What is the importance of advertising in the marketing process? List the principal advantages of advertising.

22. "Advertising is condemned only when it is abused and misused." In the light of this statement, point out the common criticisms of advertising and suggest some measures for regulating advertising.

*23. "Advertising is the cheapest method of mass communication for carrying sales message." Explain the statement. (Or, "It pays to advertise".)

24. State the important media of advertising and point out the considerations involved in selecting a medium. How can you assess the results of advertisement in newspapers and magazines?

*25. Does the advertising copy contain reading material in all cases? What are the essentials of a good advertising copy? Briefly indicate the component parts of a copy of advertising.

26. What do you mean by advertising themes and advertising layout? Indicate some common themes used in advertising. Briefly state the pattern of layout in newspapers and magazines.

27. What do you understand by advertising campaign? What are the sequential steps involved in such campaign?

28. Explain the nature and importance of marketing research. State how advertising campaign is aided by the activities of marketing research.

*29. What are the services rendered by advertising agencies to advertisers and how are the agencies compensated for their services? What is the Advertising Council of India and who are the constituent members of this body?

*30. State the importance of personal salesmanship in the creation of demand for products. Explain what special personnel problems of selection, training and remuneration are to be tackled in creating an aggressive and enthusiastic team of salesmen.

*31. What do you mean by sales promotion? To aid personal selling and advertising, what are the usual auxiliary methods of sales promotion?

CHAPTER 31 : CHANNELS OF DISTRIBUTION

32. What are the different channels of distribution for consumers' goods? Explain the factors involved in choosing a channel of distribution.

33. How can you justify that merchants and mercantile agents are the two

broad classes of middlemen ? List the important services rendered by wholesalers in the marketing process.

*34. Do you think that middlemen constitute an unnecessary element in the marketing system ? Would their elimination result in the reduction of prices for consumers ?

35. How are the multiple shops organized as a form of large-scale retailing and what are their peculiar advantages and limitations ?

*36. How are the departmental stores organized as a form of large-scale retailing and what are the typical advantages and limitations ?

37. Explain how departmental stores differ from multiple shops in the field of retailing.

38. Account for the growth of discount house as a form of large-scale retailing. Do you think that such retail establishments should be introduced in India ?

39. Discuss the main features of mail-order houses and super-markets as forms of large-scale retail organization.

CHAPTER 32 : FOREIGN TRADE

40. What are the difficulties and complications of foreign trade ? Give a brief idea of the exchange control and licence restrictions in connection with trade beyond national boundaries.

41. What are the different methods of entering into foreign trade ? Why are the indent houses and other intermediaries in foreign trade being done away with by manufacturers ?

*42. Describe the procedure which an Indian exporter has to adopt in exporting his goods and in securing payment from the importer.

*43. Describe the formalities to be observed in importing goods into India from abroad.

44. What do you mean by ship chartering ? What are the usual clauses of a charter party ? How does the charterparty differ from the bill of lading ?

45. What is a letter of credit and what is its importance ? Explain the different types in which letters of credit may be issued.

46. Write short notes on—(*a*) Open general licence (O.G.L.), (*b*) Price quotations in foreign trade, (*c*) Codes in cable message, (*d*) Shipping documents, (*e*) Rummaging, (*f*) Clearing agents, (*g*) Customs duties and (*h*) Bonded warehouse.

CHAPTER 33 : COMMODITY EXCHANGES AND FUTURES TRADING

47. What are the services and functions of commodity exchanges ? What should be the typical characteristics of commodities for their eligibility of trading on the exchange ?

*48. What do you mean by futures? State the peculiar features of such transactions.

49. Describe the constitution of any commodity exchange in India. Indicate the methods of trading followed on such exchanges.

*50. Describe the nature and functions of speculation on a commodity exchange. What are the kinds of speculative transactions that take place on such an exchange?

*51. Discuss the nature and importance of hedging transactions. Are there any limitations of hedging?

*52. What are the evils of futures trading? Explain what statutory measures have been adopted to check the evils of such trading. Briefly indicate the role of the Forward Markets Commission in this respect.

53. Describe the organized exchanges which have been established in the country for marketing any two of the following commodities—(*a*) tea, (*b*) raw jute and jute goods, (*c*) cotton and (*d*) oilseeds.

PART TEN—ROLE OF STATE IN BUSINESS

CHAPTER 34

ECONOMIC AND INDUSTRIAL POLICY

EVOLUTION OF MIXED ECONOMY

Ours is a mixed economy in which both private and public enterprises work side by side for the economic development of the country. That is to say, the public and private enterprises complement each other and they are mutually dependent. In order to realize the social objectives and economic aims, the State not only regulates and allocates economic resources of the nation, but it is an active participant in the economic life of citizens as well. For the purpose of providing social justice and an equality of opportunity to its citizens, the Directive Principles of State Policy have been enunciated and the whole economy has been geared to democratic planning. The backlog of economic development is intended to be covered within the shortest possible time through fixing overall targets and priorities in the plan and earmarking the sphere of activities for both public and private enterprises. To secure the objective of rapid industrialization, "it is best for the public sector to develop those industries in which private enterprise is unable or unwilling to put up the resources required and run the risks involved, leaving the rest of the field free for private enterprise".

The economic policy is highlighted by the adoption of a 'socialist pattern of society'. The idea of such a society has been crystallized as one in which "the means of production should be socially owned and controlled for the benefit of society as a whole". The Planning Commission interprets the socialist pattern of society as one in which "basic criterion for determining the lines of advance must not be private profit but social gain, and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in total income and employment but also in greater equality in incomes and wealth". Accordingly, the objectives of the Five-Year Plan put emphasis on the following five aspects : (*a*) sizable increase in the national income, (*b*) achievement of self-sufficiency in foodgrains by increasing agricultural production, (*c*) rapid industrialization of the country, (*d*) expansion of employment opportunities, and (*e*) reduction of inequalities in income and wealth. The Fourth Five-Year Plan

included three main objectives: (i) attainment of self-reliance, (ii) regional balance in distributing the benefits of development and (iii) economic growth with price stability. The emphasis on objectives has varied from time to time. The Third Plan called for the achievement of self-generating economy, while the attainment of self-reliance was the destined mission of the Fourth Five-Year Plan.

Features of Mixed Economy. The industrial economy in which the public and private sector enterprises work side by side for the economic development of the country is called mixed economy. Under the mixed economy, the public and private enterprises complement each other in such a manner as to function with mutual support as parts of a single mechanism. That is, the State in addition to its function of regulating and guiding the industrial enterprises in the private sector, has actively participated in the process of industrialization with a view to securing rapid growth of industries. The important features of the mixed or regulated economy are stated as follows:

1. *Demarcation of the domains of public and private sectors*—The area of operation of these two sectors has been determined in various ways by the Industrial Policy Resolution of 1956, the Licensing Policy of 1970 and the Industrial Policy Statement of 1973. Under the Industrial Policy Resolution, the industries have been divided into three categories. The first category contains a list of some 17 basic and strategic industries whose future development has been made the exclusive responsibility of the State. The second category contains a list of some 12 industries which are to be progressively owned by the State. The rest of industries in the third category is to be developed on the initiative and efforts of the private sector.

Under the Licensing Policy of February 1970, the industries have been divided into core sector, heavy investment sector, middle sector, joint sector and small-scale sector for licensing purposes. Industries in the core sector and heavy investment sector are earmarked for larger industrial houses and foreign concerns under certain conditions along with the participation of the State. In the core and heavy investment sectors, the major projects comprising the joint sector can be taken up by private enterpreneurs in collaboration with public financial institutions. The industries in the middle sector are usually meant for new and medium entrepreneurs although larger industrial houses can go in for such industries in special situations. The industries in the small-scale sector are reserved for small-scale enterprises and co-operatives.

Under the Industrial Policy Statement of February 1973, a consolidated list of 19 industries has been prepared as per Appendix I for the operation of larger industrial houses and foreign concerns provided

the item of manufacture does not fall within the reserved category of the public sector or of the small-scale sector. This consolidated list of industries includes core industries, other industries having direct linkage with such core industries as well as industries having a long-term export potential.

2. *Sectoral inter-dependence*—The division of industries into several categories and sectors does not amount to their placement in water-tight compartments. The mixed economy calls not only for an area of overlapping jurisdiction, but also for a great deal of dovetailing between industries in the public and private sectors as well as between industries in the large-scale and small-scale sectors. By supplying components and parts, acting as ancillaries or utilizing by-products, one enterprise is chained with other enterprises in different sectors.

3. *Promotion of small-scale industries*—As small-scale industries are supposed to play a crucial role by providing greater employment, effecting better distribution of national income and making larger utilization of local resources, the State would develop these industries through the adoption of some positive measures.

4. *Fiscal and financial assistance to private-sector industries*—For the development of industries in the private sector, the State would extend necessary financial assistance and fiscal help by the adoption of suitable policies thereof. For integrating the development of industries in the private sector with the growth of public-sector enterprises, the State would also provide for building infra-structure facilities and supplying trained personnel of all categories.

5. *Amenities and incentives for labour*—Recognizing the role of workers as an important partner of industrial production, the State would assume the responsibility for raising their efficiency standard by way of improving their working and living conditions, extending proper incentives and amenities to them, allowing labour participation in management and adopting several other welfare measures.

6. *Regulation and guidance of industries in the private sector*—For conforming the growth of industries in the private sector to the framework of economic and social policies of the State, the Government would exercise control over such industries in terms of the Industries (Development and Regulation) Act and other relevant statutes. Apart from these regulations, the private-sector industries would be allowed to develop with as much freedom as possible in accordance with the targets and objectives of the national plan.

7. *Ratio of investments in public and private sectors*—The public-sector outlay on industrial development has been gradually stepped up so that it can occupy a dominant place in the industrial economy of the country. From a meagre investment of Rs. 55 crores in the First Plan, the outlay of the public sector in industry and mine-

rals has increased to Rs. 938 crores in the Second Plan, Rs. 1726 crores in the Third Plan and Rs. 3338 crores in the Fourth Plan. From an equal proportion of industrial investment in the public and private sectors, the share of the public sector has become more than twice the amount of investment in the private sector during the Third and Fourth Plans.

NATIONALIZATION OF INDUSTRIES

Nationalization implies State ownership and management of business enterprises. The logic of nationalization is so well established nowadays throughout the world that all countries have adopted the principles of nationalization in some form or another. The present controversy relates, however, to the degree or extent up to which the horizon of nationalization is to be pushed through and to the advisability of nationalizing a specific concern. The motive of the State behind nationalization lies in rendering the greatest services to the people by way of maximising social welfare. The argument in favour of nationalization is based upon the advantages which are likely to be secured therefrom.

The important advantages may be briefly stated as follows : (*i*) Ownership and control, both being assumed by the State, the danger of concentrating economic power in the hands of a few persons is lessened. (*ii*) All the advantages of unified control and of large-scale operation are available through securing better co-ordination and greater economy in the working of enterprises. (*iii*) Labourers feel happy for working in nationalized enterprises for a number of reasons like absence of exploitation, greater job security and larger amenities. Moreover, asserting their role as citizens of the country they become active participants in the running of State enterprises. (*iv*) Consumers are likely to be benefited in several ways from the operation of nationalized enterprises. In cases they are charged higher prices, their individual loss amounts to the community's gain. Hence, the idea of exploitation is removed from the minds of consumers. (*v*) The State secures a balanced growth of every region by judicious dispersal of industries throughout the country and reduces the social cost of industrialization by preventing too much industrial concentration. (*vi*) Objectives of full employment and of greater economic stability can only be realized through a progressive measure of nationalization. (*vii*) The State can plan the future development of industries on a long-term basis and can conserve the wasting assets to the best interests of the country.

As against these advantages, there are several disadvantages of nationalization. (1) Operating efficiency of State enterprises is

reduced in many cases through bureaucratic control by civil servants who are cautious, conservative and fond of attending to details. As a result, nationalized enterprises may lack the flexibility and initiative of the private enterprise and for that matter, nationalization may result in increasing the administrative costs and selling prices of goods or services. (2) Accounting and financial control is usually exercised in such a manner as to cripple the progress of State enterprises. (3) Political interference in the affairs of State enterprises saps their strength and prevents their normal functioning. (4) The working of a State enterprise becomes subject to greater public control and criticism than that of the private enterprise. Consequently, rationalization schemes and other innovations are avoided for the possible opposition to them. (5) Nationalization leads to regimentation of consumers' choices. Their preference for variety and quantity of goods has to be abandoned with every growth in the frontiers of nationalization.

THE INDUSTRIAL POLICY

In February 1973, the Government of India announced its decision on the industrial policy after reviewing the Industrial Policy Resolution of 1956. The Industrial Policy Statement of 1973 reiterated that Industrial Policy Resolution would continue to govern industries for achieving the objectives of growth, social justice and self-reliance in the industrial sphere. The Industrial Policy Resolution of the Government was announced in April 1956. The resolution divides the industries into three categories as opposed to four categories contained in the old industrial policy of 1948. The new industrial policy gives an integrated picture about the role of basic and key, large and heavy, small and light industries in the planned economy of the nation, demarcating as well the domains of the public and private sectors of economy. Several other aspects of industrial policies pertaining to technical and financial assistance, location and regional distribution of industries, use of co-operatives in the development of cottage and village industries, and the importance of industrial peace have been dealt with in this policy.

Out of three categories, the first contains a list of 17 industries which are enumerated in Schedule A of the resolution. All basic and strategic industries or industries in the nature of public-utility service have been placed in this group. Some other important industries requiring huge investments which the State alone can provide have also been included in the category. The Government policy towards these industries is that the responsibility for setting up of new units would lie in the exclusive jurisdiction of the State and that the established units pertaining to these industries in the private sector would be

allowed to develop by private interests. Industries that are run as Government monopolies include railways, air transport, arms and ammunition and atomic energy. As regards other industries in this category, the State may secure the co-operation of private enterprises for the orderly growth of industries, provided the ultimate controlling power is retained by the State.

The second category contains a list of 12 industries, as enumerated in Schedule B of the resolution, and they are to be progressively State-owned. The State would take a leading part in the establishment of new units in these industries for the purpose of speedy industrial development. And private interests would only be allowed to supplement the efforts of the State. That is, these industries are expected to be developed by the State in collaboration with private enterprises in different ways.

The remaining industries have been left to the initiative and enterprise of the private sector. Even in respect of this group of industries, the State has reserved its power to undertake any enterprise when the needs of planning so require or when there are compelling reasons for it. The resolution points out clearly that the division of industries into separate categories is not intended to be a rigid one and that they are not mutually exclusive in character. It points out specifically that there is not only an area of overlapping, but also a great deal of dovetailing between industries in the private and public sectors.

As to the State assistance for the development of industries in the private sector, the State would provide the facilities of transport and other services and would give adequate encouragement through appropriate fiscal and tariff measures. In addition to the usual financial help by way of loans and advances to private industries, the State may give such assistance in the form of equity capital or debenture capital to any enterprise in the private sector. Subject to the regulatory measures of the Industries (Development and Regulation) Act and other relevant legislation, these industries are expected to grow with as much freedom as possible, particularly when they are consistent with the targets, priorities and objectives of the national plan and they fall within the framework of the existing social and economic policies of the State.

Other Aspects. *Place of small industries in the national economy* —The policy lays a great stress on the role of cottage, village and small industries towards the development of national economy. As these industries provide immediate employment to many persons, ensure a more equitable distribution of national income, and mobilize local resources, both human and material, of every region, a special attention is to be given on the promotion of small industries so that they

can become self-supporting in their existence and complementary to large industries. In addition to the old measures like direct restriction on the output of large-scale industries, preferential taxation and direct subsidy, the State is to make all-out efforts for developing small industries through the financial and technical assistance, the supply of cheap power or marketing facilities, the arrangement of working accommodation through the establishment of industrial estates, and the provision of community workshop for repairs and maintenance of equipments. Particularly, the industries organized on co-operative lines would derive substantial State help.

2. *Regional distribution of industries*—With the object of securing a balanced and co-ordinated development of industries in each region, special attention would be given towards the development of those areas which are at present lagging behind industrially or where the necessity of creating employment facilities is greater in view of the favourable location in such areas.

3. *Provision of technical and managerial personnel*—The programme of industrial development would require the help of sufficient technical and management personnel and for ensuring their availability, necessary arrangements are to be made by the State. Training facilities within the industry, both in private and public sectors, through apprentice schemes coupled with instructions in technical institutions are expected to provide requisite technical and managerial personnel.

4. *Labour policy*—The policy accepts the urgent necessity of proper incentives and amenities as well as of improved living and working conditions for the purpose of raising efficiency standard. There should be joint consultation between labour and management for the maintenance of industrial peace which is the *sine qua non* of industrial growth. Labour participation in management is particularly desirable in a socialist democracy where labour is a partner in the common task of industrial development. Public enterprises would set the example in this respect to be followed by private enterprises.

5. *Management pattern of State enterprises*—With the growing participation of State in industry and trade, the manner in which these activities are conducted and managed assumes considerable importance. Speedy decisions and assumption of responsibility are essential contributories to the success of State enterprises. The industrial policy makes it clear that State enterprises would be conducted on business lines with decentralized authority. As a criterion of control, freedom for the management team of State enterprises is prescribed as number one requirement.

Industrial Policy Statement of 1973. For ensuring the growth of all priority industries in conformity with social objectives during the

Fifth Plan, the Industrial Policy Statement of February 1973 makes out a consolidated list of 19 industries which have been mainly assigned to larger industrial houses and foreign concerns. Larger industrial houses along with their inter-connected undertakings having assets of not less than Rs. 20 crores and foreign concerns would ordinarily be excluded from such industries as are not included in the list except the cases where manufacturing is made primarily for exports. They would also be excluded from the manufacture of any item that is reserved for the public sector or the small-scale sector. For the manufacture of mass consumption goods, the co-operatives and the small and medium entrepreneurs have been tipped along with the public sector assuming an increasing role. Although small and medium-sized enterprises are supposed to produce ancillaries, they can go in for core sector units of 19 industries and even joint sector units. The joint sector units would be promoted in specific cases for the realization of Plan targets by any large or small industrial concern in the private sector under the guidance, direction and control of the Government.

THE INDUSTRIES (DEVELOPMENT AND REGULATION) ACT, 1951

With the advent of planning, the major industries in the private sector have been placed under State regulation and control according to the provisions of the Industries (Dev. & Reg.) Act. The Act came into operation with effect from May 6, 1952. Although the scope of the legislation was gradually extended to cover at one time as many as 79 industries, 41 industries were delicensed in subsequent years. Under the Licensing Policy of 1970, industry-wise delicensing which was in force was abolished. The main provisions of the Act may be stated as follows :

Existing units in the scheduled industries are to be registered under the provisions of the Act. As regards new units or substantial expansions of existing units, a system of licensing has been introduced to ensure orderly development of industries in the private sector. Industrial undertakings having fixed assets not exceeding Rs. 1 crore are not now required to obtain a licence under the Act, irrespective of the number of employed persons. The exemption limit does not apply to those existing licensed or registered units which have fixed assets exceeding Rs. 5 crores along with larger industrial houses, dominant undertakings and foreign concerns. The exemption limit does not also apply in those cases where foreign exchange requirement is more than Rs. 10 lakhs or more than 10 per cent of investment, whichever is less. The system of granting licence enables the Government to exercise a broad measure of control over several aspects like proper location, suitable

size, desirable manufacturing programme, etc. The Government is empowered to make periodical investigations in regard to the affairs of registered industrial enterprises. With a view to ensuring the development of industries in the private sector in conformity with the Plan, the Government can take over management of an enterprise that does not seem to run satisfactorily.

According to the provisions of the Act, three different bodies have been established to realize the objective of the measure. First, *the Central Advisory Council* is to make recommendations or tender advice to the Government in respect of development and regulation of all scheduled industries. This body considers the problem of enumerated industries in general without going into the details of specific problems of a particular enterprise. The second body is the *Development Council* organized for each big industry or a group of industries, and it is composed of the representatives of employers, employees and technical experts. These development councils are to devise ways and means for the purpose of raising industrial production in the private sector. For this, they are authorized to give technical advice and guidance as well as to recommend measures of rationalization and modernization. Twenty Development Councils were established up to the recent past. The third body is the *Licensing Committee* set up under the Act for granting licences in respect of new productive capacity. For speeding up the granting of licences, a new body called Secretariat for Industrial Approvals has been set up in 1973.

For the implementation of economic and industrial policy and for the co-ordination of development programmes, a National Development Council has been established as an apex body. The National Development Council maintains necessary liaison between two sectors through the activities and assistance of the Central Advisory Council and different Development Councils.

THE PROBLEM OF FOREIGN CAPITAL

Necessity of Foreign Capital. A developing country like ours finds no alternative but to secure foreign capital in its efforts to execute any scheme of large-scale industrialization. The requirement of extensive investment for acquiring capital goods and technical knowledge in the process of industrialization cannot be met from the export surplus. Exports from a developing country consist mainly of some agricultural commodities, the supply of which is inelastic in character and cannot be increased to any desired level. After meeting the home consumption, the exportable volume of goods is likely to be more or less fixed. Further, as the price of agricultural commodities is subject to wide fluctuations, a developing country cannot be assured of a

stable export earning, and the terms of trade are bound to go against it. Consequently, there appears a wide gap between the export and import of the country during the period when it obtains capital goods and technical know-how from foreign countries. Until and unless the export trade can be diversified by the inclusion of several manufactured products in the export list, unfavourable trade balance will be a continuing state of affairs. Our country today is faced with a similar situation. In order to tide over the crisis of short supply in foreign exchanges, the country has to fall back upon foreign loans so long as it cannot diversify export trade through the building of an extensive and broad-based industrial structure.

Difficulties in Securing Foreign Capital. The flow of foreign capital towards underdeveloped countries is much restricted today than it was before. A number of handicaps and uncertainties prevent the capital-exporting countries from investing funds in underdeveloped countries. *First,* the effective return on foreign investments is not attractive in many cases to induce investors to take the risks of such investments. *Secondly,* the recent political changes have reduced the certainty as to repayment of principal and payment of interest. *Thirdly,* exchange controls, high rates of taxation, and the fear of nationalization without adequate compensation have limited the inflow of foreign capital. *Finally,* exportable capital has been reduced because of rearmament requirements and of the demand for increasing living standards in investing countries.

Forms of Foreign Investments. Foreign investments may be either public or private. Foreign public investments are made by the Government of the lending country or by an international agency in the form of grants and loans. These loans are given directly to the Government of the borrowing country or to the public and private bodies under the guarantee of the Government. As these investments are made for the fulfilment of certain political ends and for the realization of some economic objectives, they are usually not very helpful for meeting the needs of industrialization. But foreign private investment can render invaluable service in developing the country's economy. Foreign private investments are made in two forms : (*a*) direct investment in equity capital, and (*b*) indirect investment or portfolio investment carrying no power of control over the enterprise. Direct investments provide permanent venture capital to industrial enterprises and supply the requisite technical know-how. Accordingly, direct investment is suitable for setting up new lines of manufacture. Portfolio or indirect investments are made in the shape of debentures and preference shares, and they can be utilized in those cases where foreign capital is necessary only to pay for capital equipments.

As regards the amount of foreign public investments, the total external assistance authorised by various friendly countries up to the end of March 1974 amounted to Rs. 15,001 crores. Of this amount, the U.S.A. provided 39 per cent, the U.S.S.R. 6 per cent, West Germany 8 per cent, the U.K. 9 per cent, other countries 19 per cent and I.B.R.D./I.D.A. 19 per cent of the total. Of the total foreign private investment of Rs. 1,253 crores at the end of March 1969, the U.K. invested Rs. 631 crores followed by the U.S.A. Rs. 219 crores and Japan Rs. 76 crores.

Government Policy on Foreign Capital. Although the industrial policy of 1956 indicated that foreign capital would be accepted in terms of the statement made by the Government in April 1949, each foreign investment in actual practice was considered on its own merits according to some criteria. A new foreign investment policy has been framed in 1968-69 and a Foreign Investment Board has been established for streamlining the procedures relating to foreign investments in India. The Board is empowered to deal with all cases of foreign private investments and collaboration in which the total equity capital does not exceed Rs. 2 crores and where the foreign investment does not exceed 40 per cent of the issued equity capital. For foreign investments exceeding these limits, the approval of the Cabinet Committee is necessary. Cases of foreign technical collaboration only can be dealt with by the relevant ministries. As guides to foreign investment policy, three lists of industries have been prepared detailing (*a*) where foreign investments would be permitted with or without technical collaboration, (*b*) where only foreign technical collaboration would be permitted, and (*c*) where no foreign technical or financial collaboration is deemed necessary. The lists of industries are liable to revision from time to time. Under the Foreign Exchange Regulation Act of 1973 which came into force on January 1, 1974, all branches of foreign companies in India and all Indian companies having foreign investments exceeding 40 per cent of their share capital are expected to bring down their non-resident shareholding to 40 per cent within a period of two years with some exceptions.

CHAPTER 35

MANAGEMENT OF STATE ENTERPRISES

FORMS OF ORGANIZATION

Since independence of the country, the Central Government and State Governments have set up a number of industrial enterprises that are owned and managed publicly by the State. The Sindri Fertiliser & Chemicals, the Chittaranjan Locomotive Works, the Hindustan Machine Tools, the Hindustan Shipyard, the Hindustan Cables, the Hindustan Steel, the Indian Telephone Industries and the Heavy Electricals are prominent examples of these enterprises. Statutory corporations like the Indian Airlines Corporation, the Air India Corporation and the Life Insurance Corporation are to be included on the list. Many new State enterprises are being added to the group from year to year. Besides these new enterprises, the Railways, Posts and Telegraphs and Munition Factories are being managed by the Central Government from the pre-independence period.

There exist three principal forms of organization which have been utilized in the running of these enterprises. *First,* departmental organization is resorted to in enterprises like the Prototype Machine Tool Factory under defence ministry, the Silver Refinery of Calcutta under finance ministry and the Integral Coach Factory and the Chittaranjan Locomotive Works under the railway ministry. The second form of organization, viz., public or statutory corporation, is to be found in the case of the Industrial Finance Corporation, the Life Insurance Corporation, the Damodar Valley Corporation, the Oil and Natural Gas Commission and the Indian Airlines Corporation. The third variety is the company form of organization adopted for the majority of public enterprises. Except a limited number of concerns, management through the machinery of a private limited company has become the common rule in our country, although the word "Private" has been deleted from the names of many Government Companies by passing special resolutions to that effect. In January 1973, the Steel Authority of India Ltd. (SAIL) was set up as a holding company for steel and associated industries. In June 1973, the second holding company, the Coal Mines Authority Ltd. (CMAL) was set up for the coal industry. On 31st March 1974, 450 Government Companies were working with a total paid-up capital of Rs. 3,229.7 crores as indicated in the following table :

GOVERNMENT COMPANIES AT WORK

(Rupees Crores)

Year ending	Public Limited Companies		Private Limited Companies		Total Companies	
	No.	Paid-up Capital	No.	Paid-up Capital	No.	Paid-up Capital
31.3.1970	81	130.2	201	1660.4	282	1790.6
31.3.1971	91	133.2	223	1931.3	314	2064.5
31.3.1972	107	156.0	245	2213.1	352	2369.1
31.3.1973	126	219.0	264	2779.4	390	2998.4
31.3.1974	148	242.7	302	2987.0	450	3229.7

DEPARTMENTAL ORGANIZATION

Features—Departmental organization is characterised by the following arrangements : (*a*) A particular Government department which is directly concerned with the relative activities of a State enterprise is entrusted with the powers of management. The overall responsibility for management rests with the chief executive of the relevant Government department, and downward delegation of authority is effected from the top executive to every part of the organization. In short, it represents the line type of authority relationships between the executives at different levels. (*b*) The same method of personnel selection and appointment that prevails in the department applies equally to the State enterprise. (*c*) The enterprise is financed through annual budget appropriation made by legislatures and its revenues are paid into the treasury. (*d*) For procedures as to budgeting, accounting and auditing, the enterprise is treated at par with other Government departments. (*e*) Being an integral part of the Government department, it possesses the sovereign immunity of the State.

Merits and defects—The greatest merit as well as the greatest defect of it lies in securing an absolute control over the enterprise. The Government can realize any social or political objective through such enterprises. Assumption of ministerial responsibility and parliamentary control by legislatures is no doubt a merit. But it becomes entirely subject to political changes and political attacks, and its fate hangs on the balance of powers between two political parties. Further, it can neither spend money freely nor formulate long-range business plans. Briefly, the enterprise cannot be run in a business-like fashion. Because of its outdated and over centralized administrative structure, it lacks the requisite freedom and flexibility essential to an efficient business

operation. Robson points out, "In matters of finance, the treasury has the incurable habit of making predatory raids on every new enterprise, regardless of the purpose for which it is run and without any coherent philosophy of public finance to guide its actions".

Evaluation—For these limitations, departmental organization remains confined to those cases only where there are compelling reasons. It becomes necessary in munition industries, the activities of which are to be kept secret on strategic grounds. Some amount of freedom has been attempted to prevail in the case of Railways by arranging a separate executive board. But the Railway Board being a plural executive is bound to become a mere puppet in the hands of the Ministry concerned. That departmental organization is not conducive to efficient operation is demonstrated by the activities of All India Radio. For cogent reasons, the All India Radio has been subject to valid criticisms for its lapses. It is pointed out that its working can be improved by adopting a corporate form of organization like the B. B. C.

STATUTORY OR PUBLIC CORPORATION

Features—The Statutory Corporation is created by a special Act which defines its powers, duties and privileges and prescribes the pattern of management. There are three distinctive features of this corporation : the nature of activity, the method of financing and the mode of management. *First,* it operates like a private business concern and deals with the public as a separate legal entity rather than as a sovereign. Consequently, it enjoys the usual rights and privileges of any business company in the private sector. *Secondly,* it is expected to be financially self-supporting. It is usually set up with a capital fund and is allowed to retain and use its earnings. That is, the corporation depends upon its earned income from the consumer payment for goods and services rather than from budget appropriations, although funds are sometimes provided to supplement its income. When the Government has to invest in or lend to these corporations large sums, parliamentary control is exercised over them. Otherwise, they are generally free from accounting controls, and in varying degrees, the audit also. *Thirdly,* as an autonomous body corporate with well-defined constitution, it is managed by a board of directors having representations from various interests. The board sets up policies which are executed by a chairman, a director general or the like chief executive in its day-to-day administration. In most cases, the employees of these corporations are not civil servants and they are appointed under terms and conditions fixed by the corporation itself. Dr. L. Gordon says. "In form, public corporation is an adaptation of the large joint-stock

company to public enterprise. Its fundamental characteristic is the total absence of profit maximization as a criterion of criticism or guide to policy. In administrative structure the apparatus common to private undertakings is bodily transplanted, but the withdrawal of profit making in itself necessitates special constitutional machinery to direct the management".

Merits and defects—It is supposed to provide "a form of management combining what is best in business with what is best in public service". Because of its autonomy, the corporation can experiment in new lines, exercise initiative in business affairs and enjoy the flexibility of operations that exists in private enterprises. It can weather political changes and maintain continuity of policy through the appointment of directors with staggering terms. Further, the law under which it operates can be tailor-made to meet the peculiar needs of a case.

But this initial adaptability of the corporate constitution to meet varying requirements is lost as soon as the corporation starts functioning. As a statute can only be amended by an Act of Parliament, the constitution of the corporation appears to be rigid and the working of the enterprise is likely to be affected seriously. The autonomy of the corporation is of doubtful character and depends on a number of factors. Divergent interests of members of the board are not conductive to an efficient working, and the corporation is likely to be conservative and callous in its operations.

Appraisal—From the experience of the DVC and the LIC, the possible shortcomings and pitfalls of a statutory corporation have been clearly revealed. Freedom of action was severely curtailed and too much Government interference greatly hampered their working. Commenting upon the flexibility and autonomy of these corporations, Mr. A. D. Gorwala has stated that "Independence is illusory, and whatever the outer appearance, essentially there would seem to be no difference between this management and management by a department of Government". He further observed that the "flexibility and business aptitude which the corporation form is designed to conserve are most unlikely to be really operative in such an arrangement. Interference by the Government in day-to-day working will be inevitable and the corporations are hardly likely to be left alone to do their work".

THE GOVERNMENT COMPANY

Features—The company law which regulates the formation and management of companies in the private sector has been utilized for setting up companies at the State level. Public enterprises that are established under provisions of the Companies Act are referred to as Government companies. A Government Company may be owned

wholly or predominantly by the State. Unlike other forms, it permits private interests to participate in its share capital so as to be transformed in some cases as public enterprises of the mixed ownership type. The company device has enabled State enterprises to function with a greater flexibility and to enjoy the usual rights, immunities and benefits of corporate enterprises in the private sector. Although the Government Company is akin to all private enterprises in its methods of organization and operation, yet it is not subject to the same kind of regulation and control as may be found in the case of an ordinary business company. The Government has prescribed a different set of rules for controlling the affairs of these Companies. Because of these rules, Government Companies can be distinguished from other non-Government companies in respect of audit, accounting and budgeting procedures.

Merits and defects—The advantages of this form of organization lie in the fact that State enterprises can be run in a business-like fashion and that they are operated, financed and taxed like a private enterprise. To justify its activities, the management team of Government Companies is induced to put forth greater efforts for increasing the operating efficiency and results of the enterprise. Because of identical conditions, the private enterprise provides a comparable standard of performance to State enterprises for assessing their efficiency. The company form arms the management personnel with right amount of freedom because of general control exercised by the Government. Consequently, management cannot shirk its responsibility. Moreover, as the problems of the Government Company are discussed and debated in the Parliament, there is an urge for becoming alert, active and efficient on the part of its management.

When a Government Company is entirely owned by the State, it may evade its responsibility and public accountability. Departmental Secretaries and Deputy Secretaries are appointed as *ex officio* directors who cannot devote proper attention and time to the task of management. By virtue of their position in Government machinery, these officials exert a dominating influence over the board of directors and prevent other directors from regular working by way of official dabbling in the company's affairs. Furthermore, as it does not function openly like statutory corporations, its activities relating to buying and selling deals or selection of personnel may create public distrust.

Critical review—This form of organization provides a greater scope for flexibility and autonomy as compared to public corporations. Accordingly, it has been accepted as the common form in organizing State enterprises. But autonomy and flexibility of this form of organization are dependent upon the personnel of the board as well as upon the functions of the board. If the board of directors is crowded with

officials, the red-tape procedures and bureaucratic delays are inevitable. Flexibility of the enterprise is bound to be lost and activities hampered by political interference. Further, autonomy depends on whether the board is a policy-making body or policy-executing body. Where the board is merely required to execute the policies formulated by a Ministry of the State, its working makes scarcely any improvement over the departmental form of organization. Mr. Gorwala has recommended that the board should be a policy formulating body so that it can maintain freedom from political influence and enjoy the flexibility and efficiency of the private enterprise.

DIFFERENCES IN THE FORMS OF ORGANIZATION

Public enterprises in India have been organized under three principal forms : (*a*) departmental organization, (*b*) public corporation and (*c*) company form of organization. Although some public enterprises are run by separate boards as in the case of Railways by the Railway Board, such boards have no independent existence and they operate as executive wings of the Department concerned. Accordingly, board management is a variant of the departmental organization and cannot be taken as a distinct form of organization. Likewise, the holding companies for steel and coal industries belong to the form of Government Companies. Differences in the forms of organization for State enterprises are stated briefly as follows :

1. *Manner of formation*—The departmental organization is created as an additional wing of same Government Department and it has no separate entity. The public corporation is brought into existence by virtue of a statute. The Government Company is formed through registration under the Companies Act.

2. *Area of operation*—The departmental organization operates in some selected areas for maintaining secrecy and security about operations. Public corporations go in for operations of national importance in the sphere of public-utility services. Government Companies are preferred for manufacturing, trading and other kinds of typical business operations.

3. *Mode of working*—Departmental organizations work as a part and parcel of the Government Departments which can maintain tight grip over them. Within some constraints, public corporations work as autonomous bodies with well-defined rules and regulations. Government Companies work in a business-like fashion with greater initiative and responsibility.

4. *Nature of management*—Departmental organizations are managed by the Departmental Ministry of the Government. Public corporations are managed by the executive authority created by the

Act. Government Companies are managed by the Board of Directors nominated by the Government.

5. *Method of financing*—Departmental organizations are financed through the annual budget appropriation and their entire income is paid into the treasury. Both public corporations and Government Companies are financed through long-term funds by way of equity and loan, and they can retain and use their earnings.

6. *Legal status*—As integral parts of the Government, departmental organizations enjoy the sovereign immunity of the State and do not become subject to taxation. But public corporations and Government Companies are separate legal entities which are sued and taxed like any private enterprise.

7. *Staffing practice*—For recruiting and compensating the personnel, departmental organizations are treated at par with Government Departments. But public corporations and Government Companies being autonomous bodies adopt any appropriate staffing practice that suits their conditions.

8. *Control system*—Departmental organizations are subject to the full blast of Government control in respect of budgeting, accounting and audit. But public corporations and Government Companies are usually free from such rigorous control.

9. *Autonomy and flexibility*—As regards autonomy and flexibility, departmental organizations have the least of them and Government Companies have the largest of them. In between the other two forms, public corporations occupy a mid-way position.

10. *Public accountability*—Public corporations and Government Companies have to give public accountability about their performance through parliamentary control. But departmental organizations have no obligations for public accountability.

11. *Pattern of ownership*—The Government Company is the only form which provides the scope for allowing the private parties to participate in its share capital partly. The other two forms are completely owned by the Government without any outside participation.

SHORTCOMINGS OF PUBLIC ENTERPRISES

The common people of India have a bitter and painful experience to see many public enterprises incurring heavy losses as years roll by. The opponents have analysed the causes of ever-increasing losses into greater details and the proponents have put forward many excuses for justifying such losses. The causes of mounting losses are as follows :

1. *Poor management*—Sound and effective management is conspicuous by its absence in many public enterprises. Because of the power of guiding, directing and regulating all other factors of operation,

management is deemed to be the most activating and creative element of any enterprise. Of all the factors, it is management alone that can determine how much accomplishment would be made in the organization. In a sense, management represents the whole business. Just as management is credited with the achievements of any enterprise, its failures or losses must also be ascribed to its management.

2. *Defective planning*—That planning does not amount to dreaming is indicated in the phrase "management by objectives." These objectives do not call for the elaboration of philosophical goals or ideological jugglings, but they imply specific objectives in terms of expected results or definite targets. As the entire managerial activity is geared into action through the formulation of specific objectives, absence of such objectives means lack of planning in the public enterprise.

3. *Unsound organizing*—Apart from the external forms of organization which are recognized as organs of action only, internal organizing provides the framework of management for playing the organs. Organizing builds the foundation for the functioning of management and makes the work of delegation, communication and co-ordination meaningful and effective in character. It is no wonder, therefore, that unsound organizing has resulted in pulling down the efficiency of public enterprises.

4. *Lack of motivation*—For motivating and inspiring the personnel towards greater performances, a number of approaches are adopted in modern management. No systematic approach to the task of motivation has been made in public enterprises and the problem is by-passed to take its own course of action. To be sure, money and machine cannot make the performance without the willing support and spontaneous co-operation of the working personnel.

5. *Unsatisfactory control*—Managerial control can never be exercised without the establishment of standards for control. Whatever may be the types of control, e.g., cost control, budgetary control, inventory control or overall control, all such controls prove meaningless unless accurate standards in terms of expected results are set up in planning. Absence of suitable control system leads to the wastage of materials, extravagance of money, dislocation in work and seepage of human efforts. The cumulative result of all such effects is loss without any limit.

6. *Over-capitalization*—Development of townships in backward regions and provision of social amenities in such places, prolonged gestation period and ill-conceived capital expenditure have made the capital structure unbalanced. The loan-equity ratio being 50 : 50 in public enterprises, the problem has been aggravated further. The result of over-capitalization is reflected in mounting losses.

7. *Bad staffing practice*—Public enterprises have been loaded with too many men who hinder the work performance rather than helping it. As a result of nepotism and favouritism in selecting the personnel, public enterprises have become the dumping ground of unfit and misfit persons who are vainly supposed to make good performances.

8. *Too much political interference*—The malady of public enterprises is heightened by too much ministerial interference in the day-to-day working. The sick and moribund public enterprises become paralysed by this political interference and the losses go on increasing steadily.

ADMINISTRATIVE PROBLEMS OF STATE ENTERPRISES

Various facets of the administrative problem of State enterprises like the suitable structure of organization, the manner of public accountability, the extent of ministerial responsibility, the degree of autonomy, the mode of financial control and auditing, and so forth have been the subject of much study, thought and discussion throughout the past decade. A number of committees and experts were engaged to seek effective solutions of such problems. But the prescriptions made about the cure for ills are so divergent and inconsistent that the views expressed by them have complicated the situation rather than easing it. Different committees that examined the administrative problems include the Production Committee of the Central Cabinet in November 1950, the Estimates Committee of Parliament in its reports for 1954-55 and 1959-60, the Krishna Menon Committee in November 1959 in addition to the Chagla Commission in February 1958 and the Planning Commission in 1952 and 1956. Opinion of the Indian expert, Sri A. D. Gorwala, was obtained in 1951 and the advice of two American experts—Prof. J. K. Galbraith and Dr. Paul Appleby—was sought in 1956. Furthermore, the problems were considered at the ECAFE conference in March 1954 and by two management seminars in December 1957 and in December 1959.

The net effect of seeking advice from so many bodies appears to be dismal. Valued opinions and sound advice have been buried in the heaps of rubbish. By and large, the opinions of individual experts are found to contain some gems which have been lost sight of and ignored by others. It is irony of fate that empirical knowledge and common sense views have been allowed to prevail over the specialist knowledge of management experts. Without going into the details of divergent views, the following aspects of the administrative problem may be studied for clarity of our understanding.

Organization. The controversy relating to organization remains confined to the choice between public corporations and limited liability

companies. Although the company form of organization has been employed in the majority cases, the recent trend of opinion is changing towards public corporations of the U. K. type. It is considered that many of the administrative problems would be solved by this switch over from the company form to the public corporation. No matter whether the organ of action is public corporations or limited liability companies, the work of organizing centres round activities for the playing of organs. Unless the organizing efforts are directed towards the creation of a suitable internal structure, managerial performance cannot improve in either of them. Both public corporations and limited liability companies are corporate forms and both ensure autonomous managerial authority. Perhaps there is little to choose between the magic powers of the two. It is the organizing function of management which alone can result in effecting some improvements in the situation.

Organizing involves determination of total activities, grouping of activities into divisions, departments or units, allocation of individual responsibilities and delegation of authority to different managerial positions in the enterprise. Because of the large size and nature of activities involved, the use of organization charts and manuals is deemed essential for elaborating duties and responsibilities of different personnel and for allowing them requisite freedom of action in matters of work performance. For obvious reasons, delegation of authority in a public enterprise must be effected in writing so as to make such delegation clear-cut and definite in character. And for this written delegation, organization charts and manuals are essential.

Public Accountability. Public accountability means the rendering of an account of performance by public enterprises to the community at large. The parliament members being the representatives of the people demand this accountability from the Minister concerned. As a result, public accountability is reduced into parliamentary control on the one hand and ministerial responsibility on the other. Parliamentary control is exercised for ensuring the fulfilment of social obligations on the part of public enterprises. In any industrial enterprise, whether public or private, there are three interested parties—the consumers, the employees and the owners. The Parliament on behalf of the parties is to see that consumers are equitably provided with quality goods and services at acceptable prices, that labourers are provided with means of enlightened social living both within and without the enterprise, and that the community as a whole is benefited by way of efficient utilization and conservation of national resources, whether material or human. For the fulfilment of social obligations, even the private enterprises have taken resort to public relations activities which are steadily growing in importance. The requirement of public relations is doubly more

important in the case of public enterprises for supplying factual information to the people, for educating them in the progress of the business and for enlisting their support and co-operation. Strictly speaking, public relations involves more than public reporting or publicity work. Unfortunately, public relations has not been given due importance it deserves in the working of public enterprises in our country.

To see the fulfilment of obligations towards the ownership community, financial audit is effected by the auditor appointed by the Government in consultation with the Comptroller and Auditor General of India. The function of financial auditing is to see that funds have been properly utilized and accounted for in the past without any wastage or misappropriation thereof. Financial audit is everywhere backward looking in character and is of little value in guiding or improving future managerial performance. In addition, the audit procedure in the Government machinery is even more to be blamed ; it is cumbersome, outdated, and devoid of objective appraisal of auditing. Briefly, the Government audit system is based on the "penny-wise and pound-foolish" principle. Wastage of small amounts is dramatised and magnified in the audit report, but the opportunity of saving millions of rupees in work performance is not detected and pointed out. The American experts have made a scathing criticism of the prevailing system of audit in public enterprises. Unfortunately, their observations have not been understood in proper perspective, and as such the advice has been rejected. To look at the question from a different angle, no amount of financial audit can put an effective check on the activities of managerial personnel if they lack the integrity of character. The staffing system must be made such foolproof that honest and upright candidates are screened out from the general mass. With the appropriate staffing practice, an improved system of financial audit may be helpful in providing a safeguard against dishonesty. But for the efficient conduct of public enterprises, internal audit by the appointment of those auditors who are well experienced with the basic activities of sales and production of the enterprise as well as self-audit by the management team itself has no comparable substitute.

Corresponding to the social obligations, the social objectives of public enterprises are to be framed in conformity with national objectives, and they are to be communicated to the parliament members and to the top managers of different enterprises beforehand. The ministerial responsibility, as a matter of practical expediency, must remain confined to the task of looking over the realization of these social objectives. Even in a private enterprise where profit motive prevails, the chief executive exercises an overall control through the selection of certain key or strategic points, and he keeps himself aloof from the details of operation at the working level. Accordingly, it is

too much to expect from a Minister concerned to answer all questions pertaining to detailed operation. As a rule, ministerial responsibility cannot go beyond the questions as to the realization of consumer objectives, personnel objectives and ownership objectives. For the accomplishment of ownership objectives, performance is required to be explained from the predetermined standards of quantity, quality, cost and time use. Achievements imply the attainment of all these standards in the performance of work, not the quantity or quality alone. One-sided statement of achievements without pointing out the failures thereto is not perhaps what the Ministerial responsibility entails. One-sided statement leads to self-complacency, the greatest killer of efficiency and initiative, on the part of managerial personnel and to the loss of public support and confidence in the working of public enterprises.

Autonomy and Efficiency. Social obligations can be discharged to the satisfaction of all parties provided the public enterprises have the privilege and capacity of working in the most effective manner. The privilege for efficient working is dependent upon the degree of autonomy granted to the management team of public enterprises. Managerial autonomy can be ensured by the introduction of "management by objectives". In some quarters, it has been pointed out that public enterprises should have no objectives other than the national objectives. The statement appears to be a misleading one and reveals a lack of knowledge as to the importance of objectives in management. The social objectives must be translated down into derivative objectives at each level of the organization. Objectives provide the nucleus around which business plans rotate.

The capacity for efficient working is to be viewed from the quality of management personnel. In addition to the knowledge, experience and analytical ability, the management personnel are required to be out and out honest in their dealings. In many cases, persons with likeable personality and snobbish loyalty to the high officials are found to be wanting in their integrity of character. Leaving aside all questions as to exceptional brilliance and high technical qualifications, managers of public enterprises must meet the requirement of absolute honesty. It is for this reason that American experts have warned against the recruitment of managerial candidates from the rank of private industrialists in India, many of whom are accustomed to making all sorts of manipulation and lack the real skill of management. Furthermore, the need for speedy decisions is emphasized every now and then. Decisions are taken and enforced by human beings, not by the form of the public enterprise. If incompetent or old-aged persons are appointed as managers of public enterprises, prompt and bold decisions cannot be taken irrespective of the form of the enterprise.

The question of setting up multi-unit enterprises is under the consideration of the Government over the decade. Prof. J. K. Galbraith has pointed out the need for establishing decentralized operating units under the command and control of a large-sized public enterprise. The Krishna Menon Committee, on the other hand, has advised the creation of single-unit enterprises rather than multi-unit enterprises. It is inconsistent to speak of the importance of decentralized authority in one breath and to object to the creation of multi-unit enterprises in the other. Strictly speaking, real decentralization of authority takes place in a divisional pattern of organization, not in the functional structure organized as single-unit enterprises. Perhaps the significance of divisional organization structures is not appreciated by many of us, and for this, we are insisting on changing the company form to public corporations or *vice versa*. Put in brief, the establishment of divisional organization structures alone can cure the ills of public enterprises. Both the enterprise accountability to the Minister and the ministerial accountability to the parliament members are bound to be improved in a divisional organization structure because of the matching of authority and responsibility at all levels. In recent years, however, the divisional pattern of the organization structure has been adopted in some cases, viz., the Hindustan Steel, the Fertiliser Corporation of India, the Heavy Engineering Corporation, the Heavy Electricals and the Hindustan Machine Tools. The establishment of two holding companies at the public sector, viz., the Steel Authority of India Ltd. in January 1973 and the Coal Mines Authority Ltd. in June 1973, has been the right step in organizing public enterprises in India. There is a proposal for establishing similar holding companies in fertilisers, petro-chemicals, non-ferrous metals and others. Though these giant enterprises are miscalled holding companies, they really belong to the class of decentralized divisional units.

Besides the external autonomy, the key to effective and high performances lies in permitting the line executive to enjoy a large measure of internal autonomy. Line executives, i.e., managers engaged in sales and production activities, must be allowed to assume the full command authority in the organization without any let or hindrance from the side of staff (or advisory) executives. It is a pity that the executives engaged in personnel, financing, accounting, etc. are treated at par with line executives, and in many cases, staff men control (or paralyze) the line executives to make adequate performances. In public enterprises, the staff men enjoy a more sheltered position and do more harm to the show of work performance. If improvements are really aimed at, the role of staff men is to be fixed according to the rules of the game of managerial performance. In addition, the chief executive position is to be organized on a team basis rather than as an individual executive or a plural executive.

CHAPTER 36

INDUSTRIAL DEVELOPMENT AND EXPORT PROMOTION

DEVELOPMENT OF LARGE-SCALE INDUSTRIES

For the development of industries in the private sector, continuous and systematic efforts are being made by the Government, and several measures have been adopted to secure this objective. Some of the important measures may be stated as follows :

1. *Promotion of basic and key industries*—The industrial structure of our country was laid on a shaky foundation and the industrial growth was of lop-sided character in the past. Some basic industries which provide essential equipments and raw materials to the industries in general were totally neglected by the foreign Government of the country. With a view to eliminating the vital gaps and missing links in our industrial structure, several projects have been taken in hand by the Government either directly or through the IDBI and the NIDC. The iron and steel industry, the coal industry and some others are being expanded and developed by the setting up of separate Government Companies. The Industrial Development Bank of India, established in July 1964, is to secure an all-round development of industries by offering financial help and promoting new enterprises in key industries. Up to the end of June 1974, the IDBI has set up three technical consultancy organizations, and actions for setting up two more such organizations in U.P. and Andhra Pradesh/Orissa have been initiated for promoting new enterprises. The National Industrial Development Corporation, established in 1954, is a promotional organization at the State level. For the purpose of strengthening industrial base, the NIDC is entrusted with the task of setting up heavy plant & machinery industry and chemical industry and with the production of heavy machine tools, heavy engineering goods and intermediates for dyestuffs and drugs. It has set up a Technological Consultancy Bureau.

2. *Development Councils and Industrial Panels*—To secure the desired development of industries in the private sector, Development Councils have been set up for each of the large industries, while Industrial Panels have been established for other industries. These bodies are to devise ways and means of accelerating industrial progress. The Central Advisory Council, constituted in terms of the

Industries (Dev. & Reg.) Act, has formed a Standing Committee that can meet frequently to advise the Government on matters of industrial development and expansion. Twenty Development Councils and several Industrial Panels were functioning in the country in recent years.

3. *The National Productivity Council*—An autonomous National Productivity Council has been established on February 12, 1958, as a society under the Societies Registration Act for the purpose of increasing industrial productivity in our country. It is composed of members representing several interests and is expected to popularise the productivity movement in the country by stimulating the growth and formation of local, regional and industry-wise productivity councils in all large, small, medium or light industries.

4. *Industrial research*—To co-ordinate and promote industrial research in the country, the National Research Development Corporation has been set up by the Government in December 1953. It is entrusted with the work of patenting inventions from research institutions and individuals and of exploiting such patents for the benefit of the country. The Corporation has five sections dealing with (*i*) Survey and Statistics, (*ii*) Industrial Liaison, (*iii*) Design Engineering, (*iv*) Technology and (*v*) Administration. Moreover, about 36 national laboratories and research institutes are working in the country within the set-up of the Council of Scientific and Industrial Research.

5. *Industrial standards*—The importance of standards cannot be overestimated in raising industrial production. One of the prerequisites of present-day mass production is the standardization of both products and processes. With the object of introducing standards in our industries, the Indian Standards Institution has been established in 1947. For improving the quality standards of products and reducing the cost of production through better methods of manufacturing, the I.S.I. is making special study and investigation so as to prescribe requisite methods of processing and manufacturing. The I.S.I. Certification Marks Scheme ensures the purchaser about the quality of products and encourages the manufacturer for production of quality goods. This institution has set up seven Division Councils—Agricultural & Food Products, Building, Chemicals, Engineering, Electro-technical, Structural & Metals and Textiles—for formulating requisite standards in these various industries.

6. *Technical assistance*—In order to provide industrial enterprises with requisite technical know-how, continuous efforts are being made by the Government to secure such help from industrially advanced countries. Since the commencemeit of the Second Five-Year Plan in April 1956, India has entered into collaboration agreements with over 2,200 reputed foreign concerns from more than 25 countries to secure

foreign technical know-how. Technical assistance has been arranged under (*a*) the Indo-U.S. Technical Assistance Agreement, (*b*) the United Nations Technical Assistance Programme, and (*c*) the Colombo Plan. Further, candidates from various fields of the industry are being regularly sent for technical training abroad under the Colombo Plan, the U.N.T.A.A. and the U.S. Point Four Programme.

7. *Financial assistance*—Financial assistance in rupee and foreign currencies is being rendered by the Government in several ways. A number of institutions have been set up to meet long-term and medium-term credit needs of the industry. Direct assistance has been given to some industries like shipping, iron & steel, chemicals, etc. Industrial enterprises in the private sector enjoy the opportunity of importing industrial equipments under the Deferred Payment Guarantee Scheme introduced by the Government. Several loans from foreign public institutions have also been secured under the Government guarantee. Besides, funds for modernizing the equipment of jute, cotton and machine-tool industries are being supplied by the Government.

8. *Suitable tariff policy*—Tariff protection is one of the important methods used by the Government to promote and safeguard the firm establishment of home industries in the face of foreign competition. On the recommendations of the Second Fiscal Commission, a permanent Tariff Commission has been established in January 1952 with the object of looking into the claims of industries for protection year in and year out. It considers the claims for protection not only on the part of existing industries, but of industries that are yet to start production as well. Besides dealing with the problem of protection, it is entrusted with some other duties : (*a*) fairness as to the prices of products of protected and other industries, (*b*) results of tariff concession on the development of industries, (*c*) removal of tariff anomalies and, (*d*) remedial measures against dumping by foreign producers or of tariff abuse by home producers.

There are about a dozen industries in the protection list at the present time. Retention prices of finished steel produced by three units in the country and prices of other products like raw rubber, tin plate, cement, jute, vanaspati, rubber tyres and tubes have been ascertained by the Tariff Commission. Tariff protection and price control in the context of democratic planning can go a long way towards the expansion and consolidation of national industries.

SMALL-SCALE INDUSTRIES AND THEIR DEVELOPMENT

It is evident from the Industrial Policy that the State is to make an all-out effort for the development of small industries, since such industries are expected to reduce unemployment, to make wider

dispersal of industries, to result in more equitable distribution of national income and to use the country's resources more effectively. The Government's emphasis on small industries is evident from the ever-increasing allocation of funds for them in successive Five-Year Plans. Small industries are confronted with many difficulties, of which four are very pressing, namely financing of production, marketing of finished goods, procurement of raw materials and outdated manufacturing system leading to high cost of production. The definition of small-scale industry has been enlarged by removing the employment ceiling and it now includes all industries with capital investments not exceeding Rs. 7.5 lakhs in ordinary cases and Rs. 10 lakhs in the case of ancillaries to large industries. The measures adopted for the development of large industries apply equally in the case of small industries. In addition, some special measures that have been taken for the development of small industries may be stated as follows :

1. *The NSIC*—The National Small Industries Corporation, established in February 1955, is the main agency in the hands of the Government to develop small industries. The NSIC is now supported by the working of State Small Industries Corporations. The important activities of the NSIC include (*a*) procurement of Government contracts for execution by small-scale units, (*b*) supply of machinery to them on hire-purchase basis, (*c*) marketing arrangements for their products, (*d*) construction and management of industrial estates at Okhla and Naini, (*e*) administration of Prototype Production and Training Centres, and (*f*) guidance to small units for working as ancillaries to large industries. From its inception up to the end of March 1974, the NSIC has supplied machines on hire purchase for Rs. 71 crores and secured contracts for Rs. 326 crores.

2. *The SIDCs*—The State Industrial Development Corporations set up by State Governments have been playing an increasingly important role for the development of small industries. The main objects of these Corporations include (*a*) aiding and promoting the interests of small-scale industries, (*b*) administrating industrial estates sponsored by the SIDCs, (*c*) supplying machinery on hire purchase, and (*d*) participating in equity capital in selected small-scale industrial units. During 1973-74, SIDCs sanctioned assistance for Rs. 26.7 crores and disbursed Rs. 18.5 crores.

3. *Financial help*—State Governments have liberalized their rules for advancing funds to small industries under the State Aid to Industries Acts. The State Directors of Industries disburse loans both for fixed and working capital purposes up to 75% of the value of assets offered as security including the asset created out of the loan. In addition, the term-lending institutions and commercial banks are giving financial assistance to small-scale industries. The term-lending

institutions together sanctioned Rs. 99.8 crores and disbursed Rs.55.8 crores in 1973-74 as against Rs. 79.8 crores and Rs. 46.1 crores respectively in 1972-73. The outstanding amount of commercial banks' advances to small-scale industries stood at Rs. 858 crores representing 12.2 per cent of the total bank credit at the end of December 1973. The outstanding amount of term loans extended by commercial banks to small-scale industries stood at Rs. 137.8 crores at the end of December 1973. Under the Credit Guarantee Scheme for small-scale industries, 196 credit institutions are giving assistance to small industries and the amount of outstanding guarantees stood at Rs. 1,396 crores at the end of March 1974.

4. *Technical help*—Technical assistance is provided to small industries by both the Central and State Governments. Technical assistance and guidance is given mainly by Small Industries Service Institutes and Industrial Extension Centres and is confined to some industries like light mechanical engineering, electrical engineering, chemical engineering, sports goods, leather goods, etc. Technical help is also given by way of imparting skill for economic investigation and business management. Regional Service Institutes in all the States have now been established. In addition to 16 Small Industrial Service Institutes, there are 5 Branch Institutes and 61 Extension Centres within the fold of the Technical Service Organization. A number of foreign experts in different lines have been engaged to demonstrate the use of improved tools and instruments, and to advise small industrialists on matters of adopting advanced methods of manufacture.

5. *Industrial estates*—Industrial estates are intended to provide small units with factory space and common servicing of their equipments so as to ensure their efficient working. Factory buildings in industrial estates are either let out to small industrialists at concessional rates or sold to them on hire-purchases basis. Of these estates, large estates are established near big cities and urban areas, and small estates in Community Development Blocks. Except the two estates at Okhla and Naini, all other estates are constructed by State Governments from the funds made available to them by the Central Government.

6. *Marketing assistance*—Marketing assistance is rendered in two different ways, namely, (*a*) through actual sales, and (*b*) market research and product design. As regards actual sales, the National Small Industries Corporation is securing Government contracts, operating mobile sales vans in rural areas and arranging foreign sales through the State Trading Corporation. The Corporation has set up seven wholesale depots and one raw materials depot for the benefit of small industries. An institute for industrial design has been established with two sections—one for handicrafts and the other for commercial

design. Different design units have been attached to the Regional Small Industries Service Institutes. Design units are intended to improve the quality of product in respect of style and finish as well as to make the product compatible with the requirement of consumers.

7. *Industrial co-operatives*—Industrial co-operatives have been assigned an important role in the development of small industries. Of all industrial co-operatives, the handloom weavers' societies occupy the largest group, and in the sphere of khadi & village industries, there are coir co-operatives, silk co-operatives and many other industrial co-operatives. For the orderly and steady growth of industrial co-operatives, the co-operative banks are now being used for routing Government loans to such co-operatives at a concessional rate. For financing industrial co-operatives, ninety per cent of the loss incurred by co-operative banks is being borne by the Government under the Small Loans Guarantee Scheme of the Credit Guarantee Corporation of India Ltd. Besides, a number of industrial co-operative banks have been set up by State Governments at the State, district or regional levels. Further, as an aid to industrial co-operatives, there is a programme for setting up many industrial estates on a co-operative basis.

Cottage and Village Industries. The facilities of technical, financial and marketing assistance that can be derived in the case of small industries are equally available to cottage and village industries. To deal with specific problems of these industries, various boards have been set up in different sectors of cottage and village industries. The activities of these All-India Boards may be stated as follows :

a. The Small Scale Industries Board—It was set up in November 1954 with the object of co-ordinating the activities of other boards and of implementing the programmes of development in regard to cottage industries of the country. It exercises a broad control over other boards and looks after their development requirements. The Board is composed of the representatives of the Central and State Governments. The Government of India has also appointed in November 1954 a Development Commissioner for Small Scale Industries who acts as the *ex-officio* chairman of the Small-scale Industries Board.

b. The All-India Handicrafts Board—It was set up in November 1952 for developing several handicrafts of the country. It covers about 40 crafts like weaving, pottery, toys, cane works, etc. Its functions are to ascertain the amount of Central Government's assistance to State Governments and to advise the Government on suitable steps to be taken for the execution of various schemes. Besides arranging for financial assistance and expert advice, the Board manages a number

of training-cum-production and demonstration-cum-service centres in selected centres of the country.

In 1958, the Handicrafts and Handlooms Exports Corporation of India Ltd. had been set up by the Central Government with an authorized capital of Rs. 1 crore. The purpose of the Corporation is to encourage quality production of handicrafts for catering to the needs of consumers, particularly in foreign markets. The Corporation is expected to improve methods and techniques of production, management and marketing. It is authorized to establish trade connections, sales depots and selling agencies within and outside the country.

c. The All-India Khadi and Village Industries Board and Commission—The Board was set up in January 1953 with a view to preparing and implementing the programme of industrial development relating to the entire khadi industry and a group of nine village industries. During the year 1957, a separate statutory commission known as "Khadi and Village Industries Commission" was established with wide executive powers in addition to the old Board which continued as an advisory body associated closely with the Commission. To further the progress of related industries, statutory State Khadi and Village Industries Boards have been created in almost all the States.

d. The Central Silk Board—Originally constituted in 1949, it was reorganized in September 1952 with wider representations and extended activities. The board is concerned with the development of every branch of the sericulture industry, beginning from the cultivation of mulberry to the weaving of raw silk. To reduce the high cost involved in the production of raw silk in India, the Board is expected to improve the rearing of silk-worm and the reeling of silk yarn.

e. The Coir Board—In order to ensure the proper growth of coir industry and the export of its products, the Coir Board was constituted in 1953. In the past, the entire production of coir fibre was utilized in making yarn for home consumption. A foreign market has since been created by the Board through organized publicity efforts. A Coir Research Institute has been set up, and the industry is expected to become a foreign exchange earner.

TRENDS IN EXPORT TRADE

The need for export promotion becomes evident from the recent trends in foreign trade. Because of the predominance of agricultural commodities in the export list, India's balance of trade cannot improve unless the export list is diversified by the inclusion of manufactured products. The structure and composition of India's foreign trade are indicated by the following two tables :

INDIA'S FOREIGN TRADE

(In crores of rupees)

Year	Imports	Exports	Balance of trade
1969-70	1,567	1,413	—154
1970-71	1,634	1,535	— 99
1971-72	1,825	1,608	—217
1972-73	1,867	1,971	+104
1973-74	2,921	2,483	—438

INDIA'S EXPORTS OF PRINCIPAL COMMODITIES

(In crores of rupees)

Commodities	1970-71	1971-72	1972-73	1973-74
Jute yarn and manufactures	190	265	250	227
Tea	148	156	147	145
Cotton yarn and manufactures	118	116	150	247
Hides, skins, leather goods, etc.	87	103	188	186
Engineering goods	126	112	130	173
Iron ore	117	105	110	133

MEASURES FOR EXPORT PROMOTION

In order to reduce the wide gap in our balance of trade and to avoid the consequent foreign exchange difficulties, the Government is making strenuous and concerted efforts to promote, expand and diversify the export trade of the country. Export promotional measures may be discussed under the following heads :

The STC and the MMTC. The State Trading Corporation established in 1956 and the Minerals and Metals Trading Corporation established in 1963 are the two institutional arrangements in the public sector for the development of trade. These two trading agencies together achieved a share of 22 per cent in the country's total imports and 14 per cent in total exports during the year from April 1972 to March 1973. The corresponding proportions of imports and exports in 1969-70 were 9 per cent and 10 per cent.

The total trade turnover of the STC amounted to Rs. 347 crores in 1972-73 as compared to Rs. 263 crores in 1971-72. Out of the total turnover, exports accounted for Rs. 170 crores and imports amounted to Rs. 159 crores during 1972-73 (April-March). The

number of export items handled by the STC rose from 10 in 1956-57 to 140 in 1971-72. Over one-half of the STC's exports originate in the small-scale sector to which it has been providing a package of services by supplying raw materials, finance, technical service, quality control, shipping, warehousing, documentation and export marketing.

The total trade turnover of the MMTC stood at Rs. 478 crores during 1973-74. The trade turnover comprised exports for Rs. 125 crores and imports for Rs. 353 crores. Iron ore accounts for about three-fourths of its total export earnings. The major items of exports handled by the MMTC are iron ore, manganese ore, ferro-manganese, coal, mica and sillimanite. In June 1974, the Mica Trading Corporation has been set up as a subsidiary of the MMTC to deal exclusively with mica trade. The major items in the import list include steel, non-ferrous metals, fertilisers and some raw materials.

The ECGC. The Export Credit and Guarantee Corporation was established in 1964 to take over the functions of the former Export Risks Insurance Corporation. The functions of the Corporation are (*a*) to administer the schemes of export risks insurance, (*b*) to furnish various kinds of guarantees to banks with a view to remedying gaps in the arrangements for export credit in the country, (*c*) to provide such supplementary credit facilities as are essential for promotion and development of exports, and (*d*) to grant credits and guarantees in foreign currency for facilitating the import of raw materials with a view to manufacturing goods for export purposes. The Corporation operates through issuing standard policies and giving five types of guarantees, viz., packing credit guarantees, post-shipment guarantees, export finance guarantees, export production finance guarantees and export performance guarantees.

During the year from July 1973 to June 1974, the number of policies and guarantees in force stood at 7319 carring a value of risks for Rs. 1,426 crores. Of this, the value of shipments covered under policies amounted to Rs. 255 crores and financial guarantees accounted for Rs. 1,170 crores. Bank finance availed of by exporters amounted to Rs. 1,261 crores. The premium income of the Corporation during 1973-74 was Rs. 2.65 crores.

Other Measures. A number of other measures have been adopted to boost up exports. They are stated as follows :

1. *Trade Development Authority*—The Trade Development Authority (TDA) established in 1970-71 makes an integrated approach towards export development and provides total assistance to selected export-worthy units mostly in small and medium-scale sectors. During 1973-74 (April-March), the TDA identified 92 new export-worthy

units so as to raise its total number of clients to 551. TDA's clients booked export orders for Rs. 68 crores in 1973-74 as against Rs. 35 crores in 1972-73.

2. *Union Ministry of Commerce*—Under the command of the Union Ministry of Commerce, a number of departments and wings are giving aid to export promotion. A Department of Export Production has been set up to pay greater attention to the problems of production, generation of surpluses and development of markets abroad for exportable items. The Department of Commercial Intelligence and Statistics collects trade information, publishes statistics and settles commercial disputes. There is an Institute of Foreign Trade for undertaking market research, area surveys and commodity studies. Another Institute for packaging gives aid in matters of packaging.

3. *Export Promotion Councils*—Under the overall guidance of the Export-Import Advisory Council, about 20 Export Promotion Councils are functioning in different industries of the country. The Export-Import Advisory Council suggests ways and means of expanding export for all industries. Individual councils help in stepping up exports in specific cases. Furthermore, a number of commodity boards for tea, coffee, coir, rubber, handloom and handicrafts give assistance to export promotion.

4. *Liberal export policy*—A large number of commodities have been freed from the shackles of export control, and the export policy has been liberalised in respect of other items. The burden of export duties has been eliminated or reduced in many cases. Drawback of import duty is granted for importing materials that are required for manufacturing goods for export purposes. Exporters are assisted by the supply of steel and other requisite raw materials. The procedure for customs drawback and central excise drawbacks has been simplified to encourage exports of goods.

5. *Quality control*—A rigid quality control is maintained by the enforcement of the Export (Quality Control and Inspection) Act, 1963 and the constitution of the Export Inspection Council. Under the Agricultural Produce (Grading and Marketing) Act, 1937 and the *Certification Marks* of the Indian Standards Institution, the manufactured products and agricultural commodities are subjected to this quality control. In the case of cotton textile, the Itex and Factual Inspection Scheme has been introduced to ensure better quality of products.

6. *Freight concessions*—Anomalies and inequities in railway freights, and shipping freights are being removed through the efforts of the Freight Investigation Bureau under the Ministry of Transport. The Government is attempting to provide increased transport facilities

to exporters by railway, airway and shipping services so that exports may not be held up. Fifty per cent concession in freight is allowed in the case of some selected commodities and twenty-five per cent in all other cases.

7. *Trade agreements*—Multilateral and bilateral trade agreements have been concluded with a number of countries. India being a party to the G.A.T.T. (General Agreement on Tariffs and Trade) enjoys a preferential treatment from member countries. Conclusion of bilateral trade agreements has become more common nowadays. To negotiate and conclude such trade agreements, the Government of India is sending regularly various trade delegations to different countries.

8. *Export processing zones*—Being encouraged by the results of establishing free-trade zone at Kandla port, the Government has taken steps for setting up export processing zones near Santa Cruz airport at Bombay and other places for promoting exports.

9. *Other ad hoc measures*—The IDBI has introduced a Buyer's Credit Scheme to enable foreign importers of Indian capital goods to finance such imports on a deferred payment basis. For outstanding export performance, awards and merit certificates are given to successful firms and institutions in India.

Export Promotion and the EEC Countries. The formation of the European Economic Community by West Germany, France, Belgium, Italy, Luxembourg and Netherlands was a matter of serious concern to India in her attempt to promote exports to West Europe. The markets of EEC countries or the European Common Market (ECM) countries accounted for only 8 per cent of India's exports which consisted mostly of raw materials with a minor share in the sphere of processed and manufactured goods. On the other hand, India had to import a substantial volume of capital goods and equipments from industrialized ECM countries. The trade deficit between India and the Community in the beginning was about thrice the value of Indian exports to the Community. The relative stagnation in Indian exports to the ECM countries was largely due to the restrictive commercial policies pursued by the member countries. The widening gap between exports and imports has been reduced to a great extent in subsequent years.

During 1973-74, Denmark and Ireland have joined the community. The U.K.'s entry into the ECM in January 1973 resulted in the termination of preferential treatment enjoyed by India's exports to the U.K. under the trade agreement of 1939. However, Britain agreed to maintain the *status quo* in respect of tariffs on imports from India for 1973 under a new agreement signed in January 1973. All

preferences enjoyed by Indian exports to the U.K. have been staggered on a sliding scale over a period of four years from 1974. Moreover, the Generalised System of Preferences intended for reducing customs duties by the advanced countries in favour of developing countries has been implemented by the EEC countries along with all other countries except the U.S.A. and Canada. The directional pattern of India's foreign trade is indicated in the following table :

REGIONAL PATTERN OF INDIA'S TRADE

(Percentage Shares)

Country	1968-69		1973-74	
	Imports	Exports	Imports	Exports
U.S.A.	30.0	17.3	16.9	13.8
ECM Countries including U.K.	19.0	23.0	23.4	23.9
ECAFE Countries including Japan	17.2	25.2	22.9	29.4
East European Countries including U.S.S.R.	16.2	19.6	13.4	19.3
Other countries	17.6	14.9	23.4	13.6
	100.0	100.0	100.0	100.0

CHAPTER 37

PUBLIC UTILITIES AND THEIR REGULATION

NATURE OF ACTIVITIES

A public utility is a special type of business that engages in supplying some essential products or services within a definite market area on a monopolistic basis. Public-utility concerns supply products or services like electricity, gas, water and transport facilities to the community. Experience shows that competition is undesirable in these lines of activities, because it leads to much social waste, hopeless duplication of plants and unsatisfactory catering of consumers' needs. Accordingly, public utilities are granted legal monopolies which place them in a sheltered position. As the well-being of the community is closely linked up with their efficient working, public utilities are not allowed to operate freely like other private enterprises. The State authority regulates the price or rate charged by them as well as the type, quality or amount of service rendered by them. The State steps in to protect the consumer from being exploited consequent upon the grant of monopoly right to public-utility concerns. With the grant of such right, there must logically accompany some duties which they have to discharge in the public interest.

Public utilities enjoy more or less a stable earning. The demand for their products or services being inelastic in nature, their income is not subject to fluctuations depending upon period of business prosperity or depression. Moreover, as they operate within a defined local area, the scope of market expansion is strictly limited in their cases. Although they have to face no competition in respect of the product or service for which they are organized in a definite place, the competition of substitute goods and services is to be reckoned with. Producers of electricity compete with suppliers of gas ; oil and coal compete with gas for heating and fuelling purposes ; and truck lines compete with railways in respect of short journey. This competition from substitutes poses a serious problem in some cases, because public utilities have to make an unduly heavy fixed-capital investment.

PECULIAR PROBLEMS

Because of their distinct nature of activities, public utilities are confronted with certain peculiar problems that are not found in other business enterprises. Their important problems centre round (1) or-

ganization, (2) ownership and management, and (3) plant location and size of units.

Public utilities are organized as companies, whether statutory or registered. In the case of giant undertakings, public utilities are allowed to grow under a special statute with necessary rules, bye-laws and constitution. Smaller concerns are usually established under the framework of the ordinary company law. Whatever might be the nature of companies, a licence from the Government is to be taken in all cases. The licence conferring monopoly and franchise rights is renewed from time to time on their satisfactory working. Through the franchise right, public utilities can acquire private properties and interfere with public amenities, as and when they become necessary.

Ownership and management may be vested in the hands of private interests, subject to the varying degrees of direct or indirect State participation. The State participation may be secured through a municipality or any other public body. The Managing Committee is usually required to have some consumers' or labour representatives on them. As regards control, public utilities occupy a midway position between the private enterprise and the State enterprise. They are subjected to a much higher degree of control than that of other industries in the private sector. Public utilities are generally provided with grants or loans made by the State.

The size of public-utility concerns is comparatively large. They are to make huge capital investments in plant, machinery, equipment or track at the outset. Further, they are to start their operations at the full stature in the very beginning and gradual expansion cannot be made like other concerns. The capital structure of public utilities is featured by a preponderance of debentures and preference shares carrying fixed rates of return. Even the rate of return on equity shares is regulated by the State. The choice of location is confined to the site selected or allotted by the Government. As they require large areas for their operations, public utilities have to depend upon the Government for the availability of space.

REGULATION OF WORKING

As already pointed out, the working of public-utility concerns is regulated in respect of the charge and the kind of service that they render to consumers. They are expected to render the maximum service at a minimum cost in the furtherance of public interest. This social objective is fulfilled by the establishment of a "fair" or reasonable rate to all parties. For the maintenance of the regular flow of service, there must be adequate returns on investments made by the contributories. At the same time, consumers' interest must be pro-

tected against the abuse of monopoly rights, and they are not to be put into hardship for getting their essential supplies. For safeguarding public interest, the quality and kind of products or services are kept under constant watch by the public authority. Sometimes, special boards or commissions are created to look after their activities from the standpoint of public interest.

It is claimed that regulation of public utilities by the State cannot be effective so long as they are allowed to be run by private interests which are guided by profit motive. Complete nationalization is the only solution for supplying desired products or services at satisfactory prices. The logic of nationalization applies to public utilities with a much greater force. However, doubts are expressed by many as to the merits of nationalization in the sphere of public-utility services. Introduction of political interference, of bureaucratic control and of red-tape methods to public utilities would put the consumers to greater difficulty. Competition from substitute goods or services may be destroyed by the State in order to maintain higher rates. To reconcile these two opposing viewpoints, it can be said that the efficient conduct of a concern is neither the monopoly privilege of State enterprises nor of private enterprises. Efficiency depends upon a large number of factors and varies from case to case, whether public utilities belong to enterprises in the public sector or in the private sector. So long as a public utility is run satisfactorily by private interests, the question of nationalization is unwarranted. The State reserves ample powers to control and regulate its activities in any way it likes. In cases of unsatisfactory working, the State has the inherent power to assume full control and ownership of any public-utility concern. Total nationalization of public utilities is probably too radical a measure to advocate under the existing conditions of our country.

DETERMINATION OF RATES

The rate must be "fair" in the case of products or services supplied by public utilities. But determination of this "fair" rate is a knotty problem, and a number of considerations are involved. Prices that are charged by public utilities are composed of the cost of service plus some percentage of return on the invested capital. Consequently, the cost structure and the amount of capital investments are to be thoroughly analysed and examined for ascertaining the fair rate. As regards cost structure, there are many questions like permissible items of operating costs, reasonable wages to workers, and necessity or adequacy of repairs and maintenance. Coming to the return on capital, the value of invested capital is to be ascertained first of all. Invested capital does not mean the share capital originally put in.

Any appreciation or depreciation in the value of investments is to be adjusted in the light of past working as well as of the general economic conditions. After ascertaining the value of capital, an equitable return is to be decided upon. Besides, rates of public utilities must reflect changes made in the general level of prices. Further, rate differential between two kinds of products or services rendered by a public utility is to be fixed by the rate-making authority. There are different groups of consumers for whom separate rates are also required to be established. For these complications, rates are usually determined after consulting various interests and obtaining answers to several queries.

As pointed out elsewhere in connection with the railway rates, the rate of public utilities cannot be fixed on the basis of cost of service alone. Allocation of common expenses over the units of production cannot be made definitely. Because of the limitation of the cost of service principle, the value of service principle is also invoked in fixing the rates of public-utility enterprises. As there are some difficulties associated with the value of service principle, the rate is ultimately determined by the principle of "what the traffic will bear".

SELECT QUESTIONS

(More important questions are marked with asterisk)

CHAPTER 34 : ECONOMIC AND INDUSTRIAL POLICY

1. "The Economic Policy of India is highlighted by the adoption of a socialist pattern of society." In the context of this statement, explain the nature and significance of the economic policy of India.

*2. What do you understand by mixed economy? Discuss the features of mixed economy or regulated economy in India.

3. Make out a case for nationalization of industries by presenting the arguments for and against it.

4. Analyse the salient feature of the Industrial Policy of India. State the main provisions of the Industries (Dev. & Reg.) Act, 1951.

5. Discuss the Government Policy on foreign capital in India.

CHAPTER 35 : MANAGEMENT OF STATE ENTERPRISES

*6. What are the different forms of organization adopted for the working of public enterprises in the country? Briefly indicate the merits and defects of each form.

*7. Bring out the important differences in the forms of organization for public enterprises in India.

8. Explain the shortcomings and defects in the working of public enterprises in India.

*9. Discuss the requirements of public accountability and autonomy on the part of State enterprises for their smooth functioning and efficient running.

CHAPTER 36 : INDUSTRIAL DEVELOPMENT AND EXPORT PROMOTION

10. Indicate briefly the measures adopted by the Government for the development of large-scale industries in India.

*11. Give an outline of the measures adopted by the Government for ensuring the development of small and village industries in India.

*12. Indicate the measures adopted by the Government of India for promoting the export trade of the country.

13. Discuss the role of the State Trading Corporation and the Export Credit & Guarantee Corporation in the promotion of export trade of India.

CHAPTER 37 : PUBLIC UTILITIES AND THEIR REGULATION

14. What are the identifying marks of public utility undertakings which place them on a different footing from other business enterprises? Do you advocate State ownership and management of public utilities under existing conditions of the country?

15. What are the considerations involved in the determination of rates on the part of public utilities? Why is the principle of "what the traffic will bear" invoked in determining rates of public utilities in many cases?

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